

No. 15299

United States
Court of Appeals
for the Ninth Circuit

WALTER J. HEMPY, as Trustee of the Estate
of Mechanix, Inc., a corporation, bankrupt,
Appellant,

vs.

JOHN HOWARD SIMS and MARVIN D.
MORROW, Appellees.

Transcript of Record

Appeal from the United States District Court for the
Northern District of California,
Southern Division

FILED

DEC - 3 1956

PAUL P. O'BRIEN, CLERK



No. 15299

United States
Court of Appeals
for the Ninth Circuit

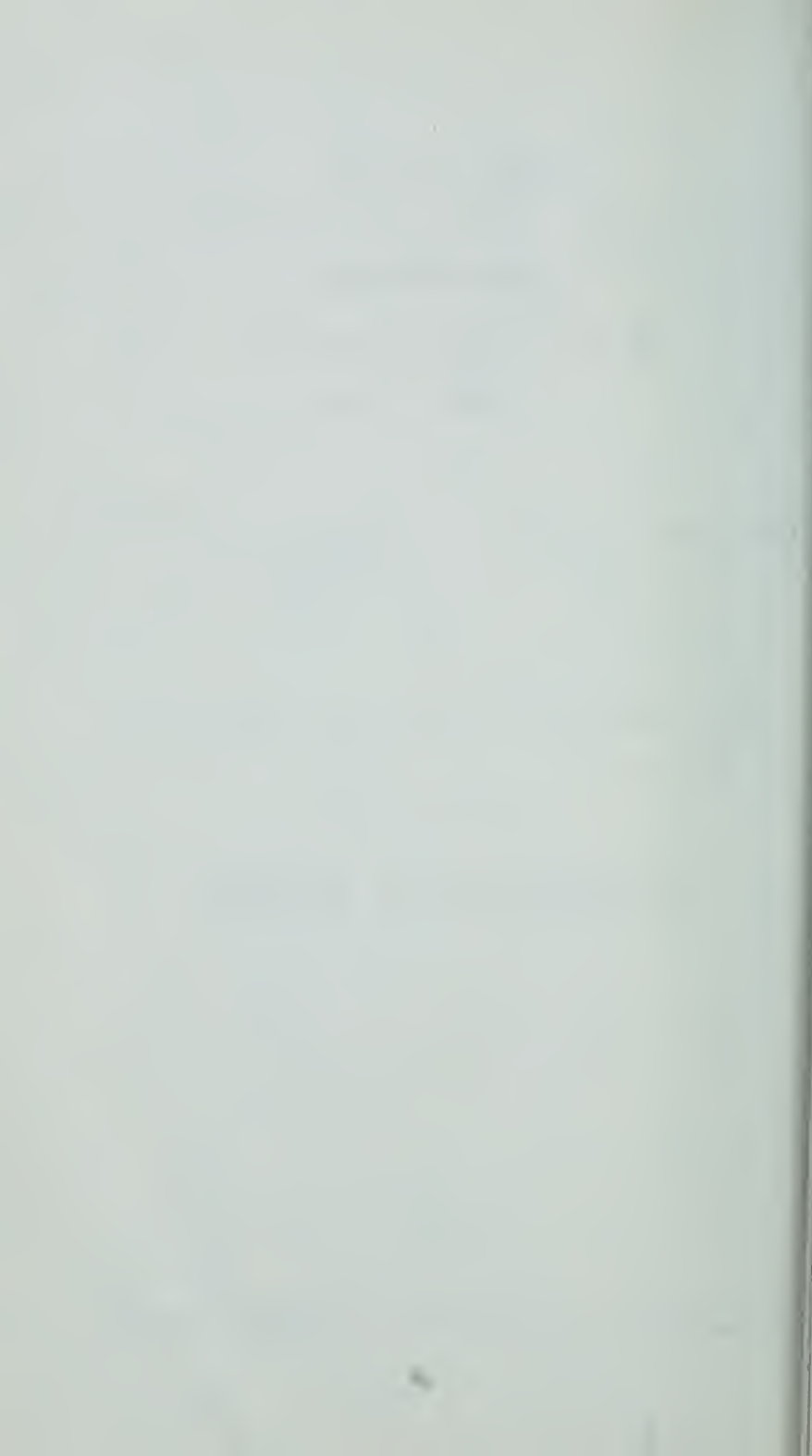
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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

PAGE

Answer to Complaint.....	6
Appeal:	
Certificate of Clerk to Transcript of Record on	14
Notice of	13
Order Extending Time to Docket.....	14
Statement of Points to Be Relied Upon on (USCA)	94
Certificate of Clerk to Transcript of Record....	14
Complaint	4
Docket Entries, Excerpt.....	3
Findings of Fact and Conclusions of Law.....	7
Findings of Fact and Conclusions of Law as Proposed by Plaintiff.....	11
Judgment	10
Names and Addresses of Attorneys.....	1
Notice of Appeal.....	13
Order Extending Time to Docket Appeal.....	14

ii.

Order for Judgment.....	7
Statement of Points on Which Appellant Relies (USCA)	94
Transcript of Proceedings and Testimony.....	15
Exhibits for Plaintiff:	
2—Operating Statement of Mechanix Inc., February, 1953	64
3—Letter Dated Jan. 20, 1953 to the Asst. Industrial Manager, U. S. Navy, Treas- ure Island, San Francisco From M. D. Morrow, President	66
Witnesses:	
Baran, Daniel	
—direct	73
Hammer, Louis	
—direct	19
—cross	20
—redirect	21
Hunt, Peter	
—direct	81
—cross	84
Mendelson, Samuel	
—direct	22
—cross	26
—redirect	33

Transcript of Proceedings—(Continued):

Witnesses—(Continued):

Morrow, Marvin

—direct	40
—cross	62
—redirect	70, 72
—recross	72

Sims, Howard

—direct	76
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THE UNIVERSITY OF CHICAGO

DEPARTMENT OF CHEMISTRY

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In The United States District Court, Northern
District of California, Southern Division

No. 34133—Civil

WALTER J. HEMPY, as Trustee of the Estate of
MECHANIX, INC., a corporation, Bankrupt,
Plaintiff,

vs.

JOHN HOWARD SIMS and MARVIN D. MOR-
ROW, Defendants.

EXCERPT FROM DOCKET ENTRIES

1954

Oct. 18 Filed complaint—issued summons.

* * * * *

1955

Mar. 5 Filed answer of defendant. * * * * *

1956 * * * * *

Apr. 26 Court trial. Evidence and exhibits intro-
duced, ruling on motion of Alfred Miller
to dismiss reserved and case submitted.
(Judge Goodman.) * * * * *

Apr. 27 Filed order for entry of judgment for de-
fendant. Findings and Conclusions to be
presented to court. (Judge Goodman.)

* * * * *

June 7 Filed findings and conclusions. (Judge
Goodman.)

7 Entered judgment—filed June 7, 1956—
that plaintiff take nothing and defendants
to recover costs. (Judge Goodman.)

* * * * *

- July 5 Filed notice of appeal by plaintiff.
5 Filed appellants' designation of record on
appeal. * * * * *
Aug. 14 Filed order extending time to docket ap-
peal to September 11, 1955. (Judge Good-
man.)
Sept. 7 Filed reporter's transcript of proceedings.
-

[Title of District Court and Cause.]

COMPLAINT TO RECOVER PREFERENCE

Complaining of the Defendants above named and
for cause of action, Plaintiff alleges:

I.

That on or about the 13th day of March, 1953,
an involuntary petition in bankruptcy was filed
against Mechanix, Inc., a corporation, in the above
entitled court, in proceeding numbered therein
41488; that thereafter said Mechanix, Inc. was
duly adjudged bankrupt; and that thereafter in
proceedings duly had Plaintiff was nominated,
elected and thereafter appointed as Trustee of the
estate of said Mechanix, Inc., a corporation, Bank-
rupt; that thereafter Plaintiff qualified and ever
since has been and now is the duly appointed, qual-
ified and acting Trustee of the estate of said Bank-
rupt.

II.

That the Defendant Marvin D. Morrow, was, at
all times herein mentioned, an officer, to-wit: Presi-
dent, and a Director of said Bankrupt; and that

John Howard Sims was an officer, to-wit: Secretary-Treasurer, and a Director of said corporation at all times herein mentioned.

III.

That within four months prior to the filing of the petition in bankruptcy as aforesaid against said *Mechanix, Inc.*, a corporation, said Defendant caused said Bankrupt to pay to each of them the sum of \$1,500.00; that said payments represented compensation by said Defendants for past services rendered and that at the time of receiving said payments said Defendants gave no present consideration therefor, nor did said Bankrupt receive any present consideration therefor.

IV.

That at the time of said payments by said Bankrupt to Defendants as aforesaid, said Bankrupt was insolvent and said Defendants knew or had reasonable cause to believe that said Bankrupt was insolvent at said time; that the effect of said payments to said Defendants was to prefer said Defendants over the then existing general and wholly unsecured creditors of said Bankrupt.

V.

That at the time of said payments to Defendants there were other general unsecured creditors, and that the assets in the estate of said Bankrupt are not sufficient to pay the claims of said creditors in full.

VI.

That this court has jurisdiction over the subject matter pursuant to the provisions of Section 60(b) of the Bankruptcy Act.

Wherefore, Plaintiff prays for judgment against said Defendants for the sum of \$1,500.00 from each of said Defendants; for his costs herein incurred and for all proper relief.

SHAPRO & ROTHSCCHILD,
/s/ By AUGUST B. ROTHSCCHILD,
Attorneys for Plaintiff.

Duly Verified.

[Endorsed]: Filed October 18, 1954.

[Title of District Court and Cause.]

ANSWER OF DEFENDANTS

Come now the defendants above named and answering the complaint of plaintiff on file herein, admit, deny and allege as follows:

I.

Answering Paragraph III, these defendants admit receiving sums from Mechanix, Inc., but otherwise deny each and every, all and singular, generally and specifically the allegations therein contained.

II.

Answering Paragraphs IV and V, these defendants deny each and every, all and singular, generally and specifically the allegations contained therein.

III.

Each defendant denies that he is indebted to plaintiff in the sum of \$1,500.00 or any sum or sums whatsoever.

Wherefore, these defendants pray that plaintiff take nothing against them and that the complaint be dismissed and that defendants have judgment accordingly.

/s/ ALFRED M. MILLER,
Attorney for Defendants.

Duly Verified.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed March 5, 1955.

[Title of District Court and Cause.]

ORDER FOR JUDGMENT

Ordered: Judgment for defendants upon findings to be presented pursuant to the rules.

Dated: April 27, 1956.

/s/ LOUIS E. GOODMAN,
United States District Judge.

[Endorsed]: Filed April 27, 1956.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS
OF LAW

The above entitled action came on regularly for trial on the 26th day of April, 1956, the Honorable

Louis E. Goodman, Judge, presiding, plaintiff appearing in person and by Shapro & Rothschild and James M. Conners, his attorneys, by Raymond T. Anixter, and the defendants appearing in person and by Alfred M. Miller, their attorney, and evidence both oral and documentary having been introduced, and the Court having been fully advised in the premises, and the matter having been submitted the Court now makes the following Findings of Fact and draws the following Conclusions of Law;

Findings of Fact

1) That the allegations of paragraphs I and II of the complaint are true as set forth therein;

2) That within four months prior to the filing of the petition in bankruptcy against Mechanix, Inc., a corporation, paid to each defendant herein the sum of \$1,500.00 which said payment was compensation to each of the said defendants for labor and services rendered to the said Mechanix, Inc., and that at the said time the said defendants each promised to continue in the employment of Mechanix, Inc.;

3) That at the time of the said payments by the said Mechanix, Inc. to the said defendants, said Mechanix, Inc. did not have sufficient cash on hand to pay all of its creditors;

4) That at the time the said defendants received the said payments the defendants did not know, nor did the said defendants have reasonable cause

to believe that the said Mechanix, Inc., was insolvent;

5) That at the time of the said payment to the defendants there were other general unsecured creditors of the said Mechanix, Inc.;

6) That this Court has jurisdiction over the subject matter pursuant to the provisions of Section 60 (b) of the Bankruptcy Act.

Conclusions of Law

From the foregoing Findings of Fact the Court draws the following Conclusions of Law:

1) That the payment by Mechanix, Inc., the bankrupt herein, of the sum of \$1,500.00 to each of the said defendants, which said payment was made prior to the filing of the petition of bankruptcy against the said Mechanix, Inc., was not a preferential payment by the said Mechanix, Inc., to the said defendants made within four months prior to the filing of bankruptcy and that the said trustee in bankruptcy is not entitled to recover from the defendants the sum of \$1,500.00 from each of the said defendants.

Let Judgment be entered for defendants accordingly.

Done in Open Court this 7th day of June, 1956.

/s/ LOUIS E. GOODMAN,

Judge of the District Court.

[Endorsed]: Filed June 7, 1956.

In the United States District Court, Northern
District of California, Southern Division

No. 34,133

WALTER J. HEMPY, as Trustee of the Estate
of MECHANIX, INC., a Corporation,
Bankrupt, Plaintiff,

vs.

JOHN HOWARD SIMS and MARVIN D.
MORROW, Defendants.

JUDGMENT

The issues in the above entitled cause having been regularly brought on for trial before the Honorable Louis E. Goodman, without a jury, the parties appearing in person and by their respective counsel, and the issues having been duly tried, and the Court on the 26th day of April, 1956, having filed its Findings of Fact and Conclusions of Law directing judgment as herein provided,

Now, therefore, it is hereby ordered that the plaintiff take nothing and that the action be and it is hereby dismissed on its merits and that the defendants have and recover from plaintiff their costs in the action.

Done in Open Court this 7th day of June, 1956.

/s/ LOUIS E. GOODMAN,
Judge of the District Court.

Entered in Civil Docket June 7, 1956.

[Endorsed]: Filed June 7, 1956.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above entitled action came on regularly for trial on the 26th day of April, 1956, the Honorable Louis E. Goodman, Judge, presiding, plaintiff appearing by Messrs. Shapro & Rothschild and James M. Conners, his attorneys, by Raymond T. Anixter, Esq., and the defendants appearing in person and by Alfred M. Miller, their attorney, and evidence, both oral and documentary, having been introduced, the court having been fully advised in the premises, and the matter having been submitted, the court now makes the following findings of fact and draws the following conclusions of law:

Findings of Fact

1. That the allegations of paragraph I of the complaint are true as set forth therein.
2. That the defendant Marvin D. Morrow, was an officer, to wit, President, and a director of Mechanix, Inc., a corporation, bankrupt, referred to in said complaint at the time of the receipt of said sum of \$1500.00, and that at the time that the defendant John Howard Sims received the payment of \$1500.00 set forth in said complaint he was an officer, to wit, Secretary-Treasurer, and a director of said Mechanix, Inc.; and that said defendants were the managing officers of said Mechanix, Inc., a corporation.
3. That within four months prior to the filing of the petition in bankruptcy against Mechanix, Inc.,

a corporation, said Mechanix, Inc. paid to each defendant herein the sum of \$1500.00 in payment for past services rendered to said Mechanix, Inc.

4. That at the time of said payments by said Mechanix, Inc. to said defendants said Mechanix, Inc. had assets reasonably valued at \$234,001.88 and total liabilities of \$288,058.57.

5. That at the time said defendants received said payments said defendants did not know, nor did said defendants have reasonable cause to believe that said Mechanix, Inc. was insolvent.

6. That at the time of said payment to said defendants there were other general unsecured creditors of said Mechanix, Inc.

7. That there are not sufficient assets in the estate of said Mechanix, Inc., a corporation, bankrupt, to pay the claims of its general unsecured creditors in full.

8. That this court has jurisdiction over the subject matter pursuant to the provisions of Section 60b of the Bankruptcy Act.

Conclusions of Law

From the foregoing facts the court draws the following conclusions of law:

1. That at the time of the payment by Mechanix, Inc., a corporation, to the defendants of the sum of \$1500.00 each, said Mechanix, Inc. was insolvent.

2. That the payment by Mechanix, Inc. within four months prior to the filing of the petition in bankruptcy against it, of the sum of \$1500.00 to each of said defendants was not a preferential pay-

ment, and that said trustee in bankruptcy for Mechanix, Inc. is not entitled to recover from the defendants the sum of \$1500.00, nor any sum.

Let judgment be entered for defendants accordingly.

Dated this — day of May, 1956.

.....

Judge of the District Court.

Affidavit of Service by Mail Attached.
(Rejected.)

[Endorsed]: Filed June 7, 1956.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Walter J. Hempy, as Trustee of the Estate of Mechanix, Inc., a corporation, bankrupt, plaintiff, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on June 7, 1956.

Dated: This 3rd day of July, 1956.

SHAPRO & ROTHSCHILD and
JAMES M. CONNERS,
/s/ By RAYMOND T. ANIXTER,
Attorneys for Plaintiff.

[Endorsed]: Filed July 5, 1956.

[Title of District Court and Cause.]

ORDER EXTENDING TIME TO DOCKET
RECORD ON APPEAL

Good cause appearing therefor,

It is hereby ordered that Walter J. Hempy, as Trustee of the Estate of Mechanix, Inc., a corporation, Bankrupt, appellant, may have to and including the 11th day of September, 1956, within which to docket the record on appeal herein.

Dated: This 14th day of August, 1956.

/s/ LOUIS E. GOODMAN,
District Judge.

[Endorsed]: Filed August 14, 1956.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD
ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, hereby certify the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court in the above-entitled case and constitute the record on appeal herein as designated by the attorneys for the appellant:

Excerpt from Docket Entries.

Complaint.

Answer.

Order for Judgment.

Findings of Fact and Conclusions of Law.

Judgment.

Findings of Fact and Conclusions of Law Proposed by Plaintiff.

Notice of Appeal.

Designation of Record on Appeal.

Order Extending Time to Docket Appeal.

Reporter's Transcript of Trial Proceedings, April 26, 1956.

Plaintiff's Exhibits 1, 2 and 3.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court this 10th day of September, 1956.

[Seal]

C. W. CALBREATH,
Clerk,

/s/ By MARGARET P. BLAIR,
Deputy Clerk.

In the United States District Court, Northern
District of California, Southern Division

No. 34133

WALTER J. HEMPY, as Trustee of the Estate
of MECHANIX, INC., a Corporation,
Bankrupt, Plaintiff,

vs.

JOHN HOWARD SIMS and MARVIN D.
MORROW, Defendants.

REPORTER'S TRANSCRIPT

April 26th, 1956

Before: Hon. Louis E. Goodman, Judge.

Appearances: For the Plaintiff: Messrs. Shapro

& Rothschild, by Raymond T. Anixter, Esq., 155 Montgomery Street, San Francisco, California; for the Defendants: Alfred M. Miller, Esq. Reported by: Kenneth J. Peck. [*]

Thursday, April 26, 1956, 10:00 O'Clock A.M.

The Clerk: Walter J. Hempy, Trustee of the Estate of Mechanix, Incorporated, Bankrupt, versus John Howard Sims and Marvin D. Morrow.

Will respective counsel please state their appearances for the record?

Mr. Anixter: Raymond T. Anixter, appearing for Shapro & Rothschild, appearing for the plaintiff.

Mr. Miller: Alfred M. Miller appearing for the defendants Morrow and Sims.

Mr. Anixter: May it please the Court, this is an action by Walter J. Hempy as Trustee in Bankruptcy of the Estate of Mechanix, Incorporated. It is an action to recover a preference against two officers and directors of a corporation for payments received by them within a few days prior to the filing of a petition in bankruptcy for past services rendered.

Within a week or so prior to the filing of the petition in bankruptcy each of these officers paid to themselves the sum of \$1500.00 each, and it is the claim of the trustee that this constituted a preference.

Now, certain things I believe can be stipulated to.

* Page numbers appearing at top of page of original Reporter's Transcript of Record.

I believe it can be stipulated that a petition in bankruptcy was filed in this matter on the 13th day of March, 1953, is that right? [3]

Mr. Miller: So stipulated.

Mr. Anixter: And that pursuant to proceedings thereafter had, Walter J. Hempy was elected a trustee of the estate in bankruptcy of this bankrupt, and ever since has been and now is the duly qualified and acting trustee of this estate.

Mr. Miller: So stipulated.

Mr. Anixter: I believe it could be stipulated that within the four month period the defendants were each paid the sum of \$1500.00 and that was for past due services?

Mr. Miller: That is correct, your Honor, except that we won't limit that to that consideration; that it was basically for past due services, but there were other factors that entered into it, and we reserve the right to offer evidence on that.

Mr. Anixter: All right. As the trustee sees it then, the issue before the Court in this matter would be the question of solvency at the time these payments were made, and whether or not the defendants had reasonable cause to believe that the corporation was insolvent, if it were insolvent; and that the other creditors, the other general unsecured creditors, did not receive the same proportion of their claims that these creditors received.

Do you have anything at this time?

Mr. Miller: No, I haven't. Mr. Anixter has made a fair statement of the issues. We are prepared to proceed. [4]

I do want to state to the Court at this time, neither Mr. Anixter nor I think it of any great moment, but the Court should know that I was one of the attorneys of the bankrupt corporation and I now appear for defendants Sims and Morrow in their individual capacities. They were officers and shareholders in the corporation.

The Court: Very well.

Mr. Anixter: Mr. Miller, may it be stipulated that at the time these payments were made Mr. Morrow was the president, shareholder and director in the corporation?

Mr. Miller: That is so stipulated.

Mr. Anixter: And that Mr. Sims was the secretary and a director and a shareholder in the corporation?

Mr. Miller: Yes. May it be stipulated further that Mr. Morrow was the sales manager and Mr. Sims the plant superintendent?

Mr. Anixter: And between the two of them they operated this business.

Mr. Miller: Yes, with the help of other key personnel.

Mr. Anixter: Now at this time, Mr. Miller, if you have no objection I would like to call Mr. Hammer, possibly out of the natural order of procedure as he has to get back to his employment.

Mr. Miller: Perfectly all right. [4]

LOUIS HAMMER

called as a witness on behalf of the plaintiff, sworn.

(Testimony of Louis Hammer.)

The Clerk: Please state your name to the Court.

A. Louis Hammer.

Direct Examination

Mr. Anixter: Q. Mr. Hammer, you work with Mr. Walter J. Hempy, the trustee in this case, do you not? A. I do.

Q. And you assisted him in the handling of this matter of Mechanix, Inc., the bankrupt?

A. That is correct.

Q. And as a matter of fact you were in charge of noting the receipts and disbursements?

A. Yes.

Q. And you are familiar with that of your own knowledge? A. Yes, sir.

Q. Now, can you tell us how much the trustee has on hand at the present time?

A. \$27,044.41.

Q. \$27,044.41? And those are the entire assets collected by the trustee?

A. That is the net amount available at the present time. There were additional amounts collected, but there have been [5] disbursements for expenses and so forth.

Q. And out of this nothing has yet been paid to any creditors?

A. That is correct, with the exception of priority wage claims.

Q. Have the priority wage claims been paid?

A. Certain ones have.

Q. How much has been paid to the priority wage claims? A. Approximately \$250.00.

(Testimony of Louis Hammer.)

Q. Other than this no payments have been made to creditors? A. That is correct.

Mr. Anixter: That is all.

Mr. Miller: Just one or two questions.

Cross Examination

Mr. Miller: Q. How much are the claims?

Mr. Anixter: Well, I was going to prove that with someone else. About \$150,000.00 worth of claims are on file.

Mr. Miller: Q. Mr. Hammer, do you have a list of the assets of the corporation?

A. No, I only have the list of the receipts taken in from the sale of the assets.

Q. Do you know whether or not all of the assets have been liquidated and reduced to cash?

A. To the best of my knowledge, they have. [6]

Q. Do you know that some of the assets of the corporation consisted of claims against the United States Government and its various agencies deriving out of ship repair contracts performed by the corporation for the Government?

A. I was aware of that, but I believe the collection of those accounts were in the hands of the trustee's attorney and I am not familiar as to the listing of them.

Q. You don't know what the result of the negotiations have been.

A. The only results that I can put forth here is that there has been \$14,890.06 collected on accounts receivable.

Q. Does it designate the job or jobs?

(Testimony of Louis Hammer.)

A. No, it doesn't.

Q. Again it may well be that certain negotiations are still open, is that correct?

A. It could be.

Q. Then your testimony that all assets have been liquidated would simply be your opinion not based on fact.

A. That is correct.

Mr. Miller: We ask that that answer be stricken by your Honor, that all assets have been liquidated. I thought the gentleman had the records available when I asked the question.

Mr. Anixter: I have no objection.

The Court: All right.

Mr. Miller: Q. If I understand your answer correctly, Mr. Hammer, you simply have a record of receipts? [7]

A. Yes, sir.

Q. Without reference to the particular asset?

A. That's right. For example, I have here—well, the only one particular case that I note here on the record is that of the Treasurer of the United States, repair of a certain General Black.

The other large amount that I have is just a collection from the Bank of America, balance due on a contract. I don't have the data as to what particular contract that is.

Mr. Miller: No further questions.

Redirect Examination

Mr. Anixter: Q. Mr. Hammer, how much does this show that the trustee received from the repair of the General Black?

A. \$543.90 on November 30th, 1955.

(Testimony of Louis Hammer.)

Mr. Anixter: That is all.

Mr. Miller: Well, do your records show whether that was the result of renegotiation or simply a payment on the amount admittedly owed?

A. It doesn't show in the accounting records that I have available here.

Mr. Miller: I see. No further questions.

The Court: That is all. Witness excused. [8]

SAMUEL MENDELSON

a witness called on behalf of the plaintiff. Sworn.

The Clerk: Please state your name to the Court, sir.

A. Samuel Mendelson.

Direct Examination

Mr. Anixter: Q. Mr. Mendelson, what is your occupation?

A. I am a Certified Public Accountant.

Q. And, Mr. Mendelson, did you at my request examine the books of Mechanix, Inc.?

A. Yes, sir, I did.

Q. And what were you requested to look for?

A. You specifically requested that we not do a complete examination but just take the books and records and determine the question of solvency as at February 28th, 1953, which we did.

We examined the books and records maintained by the bankrupt corporation. We examined certain documents on file in the office of Burton J. Wyman, the Referee in bankruptcy, and I prepared a balance sheet from the books and records as they stood, and then I have adjusted certain figures

(Testimony of Samuel Mendelson.)

therein from the information on file in Judge Wyman's office.

Q. Do you have a copy of that balance sheet?

A. Yes, sir, I do. [9]

Q. This is the one you are using now?

A. Well, I have some extras (handing documents to counsel and the Court).

Q. Now, Mr. Mendelson, this is the original of the balance sheet?

A. Yes, sir, that is the original.

Mr. Anixter: I would like to introduce this into evidence as plaintiff's exhibit A.

The Court: All right, admitted.

(Balance sheet admitted into evidence as Plaintiff's Exhibit No. 1.)

Mr. Anixter: Q. Now Mr. Mendelson, as a result of your examination at this time what do you find the condition of the corporation to be?

A. Well, in examining the books and records, the corporation had a deficit capital position of \$33,955.75. Upon examining the files in the Referee's office, that was adjusted upward by some \$26,755.97, making a total deficit of \$60,711.72.

Q. And what was the reason for this upward adjustment?

A. Well, there were certain items for example, as I read from my prepared schedule on the last page. The inventories for the records were \$4,095.00, but the bankruptcy schedules as appraised indicated that they were worth only \$2,000.00.

And there were certain priority wage claims

(Testimony of Samuel Mendelson.)

which were not recorded in the books and records for \$3,633.09. Certain tax claims from the United States Government and the State of California were recorded on the books at \$8,255.59, but the files indicate that the claimed amount was \$26,081.24.

There was a claim by the United States Government accounting office for \$1,120.00 that was not reported.

The notes payable to the Bank of America per the books was \$54,888.57, and the schedules in bankruptcy indicated that the obligation was \$73,029.92.

The just general trade creditors, the books indicated \$145,667.21, and the files indicate \$157,707.02.

Those were the total increases in obligations. Now, there was decrease noted because the books and records disclosed an overdraft position of \$18,686.02, whereas the trustee's files indicated that an on-hand amount when the trustee took over was \$9,412.91, so I have adjusted that overdraft position to make another net adjustment of \$26,755.97.

Q. Then as of this time, if I understand you correctly, there was a net deficit of \$60,711.72.

A. Yes, sir.

Q. Now, did you examine the claim docket on file in the Referee's office? A. Yes, sir, I did.

Q. What are the total amount of claims that have been filed in the bankruptcy proceedings?

A. The Referee's file indicates that priority claims [11] totalled \$30,834.33; unsecured claims, \$160,665.65; the total claims on file of \$191,509.98.

(Testimony of Samuel Mendelson.)

Q. Now, in examining—by the way, did the books show a withdrawal of these checks for \$1500.00 in favor of the defendants?

A. May I examine this paper?

Q. Yes. In favor of Sims and Morrow?

A. Yes. I have here the payroll sheet which is dated—it says “To J. M. Sims, retroactive 1/4/53, 3/8/53, salary due at \$150.00 a week, a total of \$1500.00.”

Now there are deductions of social security, taxes, and withholding, and net withdrawal on check number 4891 for \$1172.50.

The Court: What was the date of the check?

A. I am not certain. This record indicates 3/8/53. The payroll was being written on the 15th, and I would presume from this that this was drawn on the 15th day of March, 1953.

Mr. Miller: We ask that last statement be stricken, the presumption.

The Court: Well, when I consider this, the figures will indicate.

Mr. Miller: Actually, I think it was drawn on the 8th.

Mr. Anixter: I think we can agree it was.

Mr. Miller: The Receiver was in possession by the 15th.

The Witness: A. The following check is check [12] number 4890, and that is drawn to M. D. Morrow, and the same statement is there, “Retroactive 1/4/53, 3/8/53, balance of salary due at \$150.00 a

(Testimony of Samuel Mendelson.)

week, total of \$1500.00," and the necessary deductions, and a net of \$1172.50.

Mr. Anixter: Q. Now, Mr. Mendelson, your statement here was prepared as of February 28, 1953? A. Yes, sir.

Q. From your examination of the books and the court records, would you say that was substantially a correct statement of the company's position as of March 8th, 1953?

A. I can't see that there would be any radical change, Mr. Anixter.

Q. Well, you would say this was a fair statement of it, then? A. Yes, sir.

Mr. Anixter: That is all.

Cross Examination

Mr. Miller: Q. Mr. Mendelson, after you looked at the Referee's file in this matter, did you make any attempt to verify any of the statements set forth in the files or any of the claims filed?

A. As to the amount, sir?

Q. Yes.

Q. No, sir, I did not. Mr. Anixter asked specifically that [13] I just examine the records to determine the total claims filed and the books and records to determine what they disclosed.

Q. Did you examine the schedule filed by the debtor corporation? A. Yes, sir, I did.

Q. And did you note the summary, the end of the schedule following Schedule B, showing liabilities of \$234,502.79 and assets of \$260,133.12?

(Testimony of Samuel Mendelson.)

A. Yes, sir, I saw this schedule.

Q. And you note that that schedule B, 3-A, there were debts due on open accounts as scheduled in the sum of \$203,720.21? A. Yes.

Q. And in your report you schedule accounts receivable \$150,560.06 adjusted?

A. There are no adjustments, sir.

Q. Pardon?

A. There are no adjustments to accounts receivable.

Q. I am sorry. Oh, no. You have total assets of \$201,342.92. A. Yes, sir.

Q. Can you explain the difference in those figures?

A. Well, I have discussed this matter with Mr. Anixter, and there were certain items he indicated that the bankrupt corporation had claimed against the United States Government for ship repair contracts. There was a letter in the file which [14] I saw which indicated that there were certain items the corporation felt were due it, but on the strength of that in preparing the financial statement I could not put out a financial statement solely on the basis that an item is claimed.

We would have to have far more evidence than that to support the inclusion of an account receivable unless it was validly put in there.

We would prefer to put a financial statement out of that kind indicating a claim valued at one dollar for the purposes of the statement, so that at a subsequent time when it was determined to be

(Testimony of Samuel Mendelson.)

good, then it could be included at its realizable value.

Q. Another way of doing it is to try to verify the account with the debtor, isn't that correct?

A. Well, that is true. You can confirm the account with the debtor and see if its amount is owed.

Q. Did you attempt to do that, Mr. Mendelson?

A. No, sir, I did not.

Q. Did you value the claim at one dollar?

A. I did not.

Q. You took the figure that was suggested——

A. (Interposing): I took the book figures that had been recorded up to February the 28th.

Q. Did you talk with Mr. Morrow or Mr. Sims or any of the [15] former officers or employees of the company——

A. (Interposing): No, sir.

Q. ——regarding the extent of that claim?

A. No, sir, I did not.

Q. Did you discuss it with Mr. Anixter?

A. Yes, sir.

Q. Did you discuss it with anyone else?

A. No, sir.

Q. Were you told that the claims were being renegotiated with the Government?

A. No, sir, I did not. No one told me that.

Q. Does the job under the name of "The Union" mean anything to you?

A. Mr. Anixter asked me to look at the accounts receivable and see if it indicated there anything

(Testimony of Samuel Mendelson.)

on the Union. I found a ledger page on which the account balance was zero.

Q. Did you inquire as to whether or not the Union contract was subject to renegotiation?

A. No, sir.

Q. In checking the books of the company did you observe that 98 out of 100 jobs performed by the company had been renegotiated?

A. No, sir, I didn't.

Q. And that additional payments had been received?

A. I had not made that detailed an examination. [16]

Q. If I understand correctly, this statement of accounts receivable, contracts receivable, \$150,-560.06 as set out in your report——

A. Yes, sir.

Q. ——under date of April 26, 1956, is what you determined the amount to be without regard to any contracts that were subject to renegotiation.

A. I accepted the books and records as they were presented and completed.

Q. Did you see any records at all that referred to renegotiable contracts?

A. The only thing that I saw was this letter sometime in January which indicated that they were dissatisfied with the way the contract had turned out and they asked for some additional monies.

Q. When you talk about the books and records, you are speaking of this statement that you pre-

(Testimony of Samuel Mendelson.)

sented, Exhibit 1? That is what you took off the bankruptcy books, is that right?

A. Yes. Those books and records were completed as of the 28th day of February and I took them as they stood.

The Court: Now the attorney is probably talking about something outside the record or books. Did you examine anything outside the books?

A. No, sir, I didn't.

Mr. Miller: Q. Were you told by Mr. Anixter that the [17] trustee had hired Mr. Morrow and Mr. Sims on a salary following the bankruptcy to assist in renegotiating contracts?

A. No, sir, he did not tell me.

Q. If I understand it correctly—I think this will sum it up—you were not advised to give any consideration to renegotiable contracts, nor did you give consideration to renegotiable contracts.

A. No, sir, I did not. But if I may point out one thing, Mr. Miller, you have in the schedule an estimated accounts receivable figure of \$203,000.00. I have in the statement a hundred and fifty thousand. Should those accounts receivable be adjusted, assuming that we would adjust them to the figure that the bankrupt filed, they would still be in a deficit position of about \$7,000.00, from the books and records. You have a net capital deficit of some \$60,000.00. You deduct fifty three thousand from that, you still have a deficiency position of seven thousand odd dollars.

Q. Well, does this take into consideration the

(Testimony of Samuel Mendelson.)

possibility of the income taxes being adjusted?

A. No, sir.

Q. And refund made to the corporation?

A. No, sir.

Q. To what extent would the corporation or might the corporation be entitled to recover income taxes paid to the United States Government for the years preceding 1953? [18]

A. The only tax return that I saw indicated that they had paid some sixty six hundred dollars.

Mr. Anixter: That is for what period?

A. For the period ended February 28th, 1952. I would imagine, if these books and records are complete, that that sum would be recoverable. But I wouldn't be prepared to state that that is the case unless I was able to pursue the matter a little further.

Mr. Miller: Q. You were not asked to verify that or look at it? A. No, sir.

Q. Now, again referring to these adjustments for example, the United States Government Accounting Office claim of \$1,120.00, do you have anything in your file to indicate the basis for that claim?

A. No, sir, it was just indicated on the files of the Referee in bankruptcy that this was a priority claim filed by the United States Government Accounting Office.

Q. It was not listed in the schedule of the bankrupt? A. No, sir, I didn't see it.

Q. From that you would draw the inference that

(Testimony of Samuel Mendelson.)

it was a disputed claim? A. No, sir.

Q. As an accountant.

A. I don't know the nature of the claim and I could not tell [19] you whether it was disputed or not.

Q. Well, when information reaches you regarding a claim against a company where the claim is not reported on the books of the company, and we will assume a case where you are the regular accountant for the company, would you treat that as a valid claim?

A. No, I would refer to counsel to determine whether the claim is valid. That is not my position to determine whether items claimed against individuals whom I do accounting work for is a valid claim or not. I have to get a legal opinion if there is a dispute.

However, I can point out to you, Mr. Miller, for example, per the schedules in the bankruptcy you indicated that \$8,255.00, or \$8,500.00, as I recall it in round figures, for tax claims. Those tax claims were something in excess of \$26,000.00.

Now I don't believe that the United States Government makes in general erroneous claims. I have at times found that they sometimes will set their sights a little high, but in general——

The Court: All the accountant has done, he has taken what he found in the books of the Referee in bankruptcy and made his calculations, and I wouldn't be particularly interested in his view as to the validity of the claims.

(Testimony of Samuel Mendelson.)

Mr. Miller: No, your Honor, but there was a possibility [20] that these claims are not valid and should be set out as disputed claims rather than liabilities.

The Court: Well, but the witness has merely stated the extent of his labors and it has been limited to what he found in the records.

Mr. Miller: Very well.

The Court: It is worth what it is worth as a statement of what is in the record.

Mr. Miller: And we want to be sure about the source of his information. And also what he does in other cases might shed some light in this situation.

I have no further questions.

Redirect Examination

Mr. Anixter: Q. Mr. Mendelson, you were asked about tax refunds. A. Yes, sir.

Q. They would only be entitled to a tax refund on the 1952 taxes if they were running at a loss in 1953, is that correct? A. Yes.

The Court: You mean by offsetting subsequent years.

A. Yes, sir. You are permitted to carry back the losses.

Mr. Anixter: Q. Now in going over the books of the corporation you came across these various jobs that the company had been doing? [21]

A. Yes, sir.

Q. And were there any figures set up as ac-

(Testimony of Samuel Mendelson.)

counts due from the Government on these jobs which corresponded to the figures filed in the bankruptcy proceedings?

A. Well, you specifically asked me, Mr. Anixter, the Union job.

Q. Yes.

A. And I will refer again to their books and records under the United States Navy. I find a page here indicated "U. S. Navy" and then in parentheses A. I. M. I don't know what that indicates. But on November 20th, 1952, I have an entry, a debit entry for \$325,216.00; and on the 26th day of January, 1953 I have a final cash payment on that debit of \$22,948.25, and the account is zero. There are no other postings.

Q. As far as their records show then, that account is completely paid up? A. Yes, sir.

Q. And Mr. Mendelson, as a matter of accounting practice if you were informed that the company whose books you were auditing had several disputed claims against anybody, whether the Government or anyone else, how would you list those claims?

A. Well, as I stated to Mr. Miller, if there were claims of any kind where there was litigation involved we generally tried to get an opinion by the attorney of the company as to [22] the validity of the claims. If there is great doubt as to the collectibility of any item, we would merely footnote the financial statement to the effect that there was a claim pending against a certain company.

(Testimony of Samuel Mendelson.)

The Court: Mr. Anixter, I don't see the materiality of this. Was there some examination conducted in the bankruptcy court with respect to the claims—with respect to claimed assets of the bankrupt which were collectible of this nature.

Mr. Anixter: Yes.

The Court: This witness took no part in that?

Mr. Anixter: No, he didn't take any part in that. But I am trying to bring out that as a matter of accountancy practice in valuing the assets of a company for the purpose of the determining whether it is solvent, whether they have saleable assets to meet their liabilities, how an asset of this kind would be regarded, because it is unquestionable that without this particular type of asset this company was hopelessly insolvent.

The Court: Well, I rather gathered from some questions Mr. Miller asked that he might be making some contention that although the company was adjudicated—there was an involuntary petition, was there not?

Mr. Anixter: Yes.

The Court: Nevertheless, he might be making some contention that there were some other assets, unliquidated, [23] in the form of claims against the Government that might have a bearing, if they were correct, on the validity of the claims for the refund of these payments to the two officers.

But I don't see what light the accountant can throw on that. That is what prompted my questions. He must have conducted some examination

(Testimony of Samuel Mendelson.)

in the bankruptcy court as to the nature of any such claims. Was there?

Mr. Anixter: Yes, there was, and I am going to present a legal opinion later on the value of these claims.

The Court: All right.

Mr. Anixter: Q. Now Mr. Mendelson, you were asked several questions by Mr. Miller about the renegotiation or information you received. Now so far as you know there hasn't been any renegotiation requested by the Government?

A. None that I know of.

Q. You merely took your examination from the books and records of the company and the bankruptcy record? A. Yes, sir.

Mr. Anixter: That is all.

Mr. Miller: Just one more question: What was the net income of the corporation for the year ending February, 1952, as indicated on the Federal tax return.

A. I don't have it. Excuse me, I will get it.

(Witness left stand and returned.)

I have here a United States Government corporation income [24] tax return indicating the fiscal year beginning March 1st, 1951, and ending February 29th, 1952 and it shows per the attached schedule a net income of \$22,501.08.

Mr. Miller: Thank you, Mr. Mendelson. I have no further questions.

The Court: That is all. Witness excused.

Mr. Anixter: The trustee rests.

Mr. Miller: I move for dismissal, your Honor, on the ground that there is no showing at this point that the defendants who received the money did so with knowledge of any insolvency. This is all subsequent to the time of the payment, which counsel and I both agree was March 8th, 1953.

We submit the matter, your Honor, and ask for dismissal.

Mr. Anixter: If it please the Court, it has been established that these two defendants were the president and secretary respectively, of the corporation, directors of the corporation and shareholders of the corporation, and between them owned and operated the corporation.

The statements from which the accountant testified was prior to that time, and at about that time, and as testified to him reflected the condition as of March 8th when the payment was taken by them; and I will submit that the officers and directors of the corporation are presumed to have knowledge of the affairs of the corporation, and they certainly are chargeable with such. [25]

If the corporation is insolvent at that time, the officers and directors certainly know it. You don't have to prove anything further from an officer, director and shareholder of the corporation.

Mr. Miller: I should think you have to go this far, your Honor, and show that the defendants had in their possession and available to them a balance sheet which would reflect the condition. We don't know. We of course aren't in the business. We are attorneys.

But our clients don't know the exact condition of their business or everything about the affairs of this particular business except as it comes to them through statements furnished to them by accountants, and we know that those statements are usually involved anywhere from ten to thirty days following the close of the particular business.

We may be familiar generally with the affairs, that's true, but we don't know at that time whether or not a particular business is solvent or insolvent.

And there is no showing here that these men knew that the company was insolvent or that they had this information furnished to them prior to the time that these checks were drawn.

We submit that there is no showing, no evidence from which an inference could be drawn that would charge these men with knowledge of insolvency, if in fact it was insolvent. [26]

I submit, your Honor, that the motion to dismiss should be granted.

The Court: Mr. Miller, wouldn't there be a reasonable inference that when the officers of the company, about a week prior to the filing of an involuntary petition for bankruptcy for long past due monies owed, there is a reasonable inference that they knew that there was some need for getting this money out at that time? I am just speaking in terms of the *prima facie* showing.

Mr. Miller: Of course I may be thinking a little bit ahead, your Honor, of the reason why and how it happened that the money accumulated.

The Court: It is *prima facie*, but I think if that

is all that would be sufficient to decide the motion to dismiss. There is no question that these claims would have priority?

Mr. Anixter: Yes.

Mr. Miller: There is that other question, your Honor, a matter of defense. These claims were for salaries, not for compensation as officers and directors, but for actual salaries earned by these men, by Mr. Morrow as sales manager and by Mr. Sims as plant manager and superintendent.

The Court: How much was it? \$150.00 a week?

Mr. Miller: \$150.00 a week. Of course there was a maximum of \$600.00, isn't that correct, that could be subject to priority? [27]

Mr. Anixter: The limit of the amount that could be claimed as a priority would have been \$600.00 in each case. But of course there is a substantial question of law whether or not an officer and director is entitled to a wage claim as priority.

Mr. Miller: I don't believe he would be entitled to it as an officer or director.

Mr. Anixter: Well, there are several cases on this. It is a question that has been disputed on a number of occasions and something on which I was going to submit authorities if that gets to be a point.

Mr. Miller: That is satisfactory, your Honor.

The Court: So there might be six hundred of the eleven hundred odd dollars that might be a priority claim?

Mr. Miller: That is correct.

The Court: And there would be assets sufficient

to take care of the priority? They have been paid, haven't they?

Mr. Anixter: Apparently some of them have been paid, but not all of them. Some of the priority claims which are still on file is one by the Labor Commission for wage claims.

The Court: Is that large?

The Witness: A. It is over \$3,000.00.

Mr. Miller: I understood that had been paid.

The Court: Anyway, the money on hand is more than sufficient to pay the wages, but only enough to pay a very small dividend. [28]

Mr. Anixter: I think it would be, yes.

The Court: Well, I will reserve ruling on the motion to dismiss and you can present the evidence.

Mr. Miller: Mr. Morrow.

MARVIN MORROW

called as a witness on behalf of the defendants.
Sworn.

The Clerk: Please state your name to the Court.

A. Marvin Morrow.

Direct Examination

Mr. Miller: Q. Mr. Morrow, you are one of the defendants in this case, is that correct?

A. Yes, sir.

Q. And you were one of the original stockholders of Mechanix, Inc.? A. Yes, sir.

Q. And Mr. Sims is the other principal stockholder, is that correct? A. Yes.

Q. When was the company formed?

A. The company was formed in early 1951. I

(Testimony of Marvin Morrow.)

think it actually commenced operations in about March of 1951.

Q. And what type of business did it conduct?

A. Well, we did machinery installation, shipping repairs, most generally having to do with ships and related machinery and equipment.

Q. Where was the company located?

A. Pier 20, San Francisco.

Q. Were you an officer of the corporation?

A. Yes, sir.

Q. What was your title?

A. I was the president and acted as sales manager.

Q. Were you employed by the corporation?

A. Yes, sir.

Q. In what capacity?

A. As a sales manager. I obtained the work or contracts that we worked on.

Q. And during the period January 4th and 5th, 1953, through March 8th, 1953, what salary were you entitled to receive?

A. We were entitled to \$300.00 a week that we had set up on the books of the corporation.

Q. How much time did you devote to the enterprise?

A. Well, it is awfully hard to determine. I imagine that I would devote, oh, perhaps sixty or seventy hours a week to the company.

Q. How would this time be spread?

Mr. Anixter: I will object to that on the grounds that it is incompetent, irrelevant and im-

(Testimony of Marvin Morrow.)

material. I don't see [30] what the materiality is. He worked for the company, no question about it.

Mr. Miller: Well, as long as we have a stipulation that his compensation was for his wages as an employee and not compensation as a director or officer, Mr. Anixter, that is the point I am making.

The Court: Ask him what the nature of his services were. What kind of work did you do?

The Witness: A. The nature of my work was to negotiate for the work with the various agencies for whom we worked, both private and Governmental; to keep apprised of the jobs which were in the offing, let's say; to know the trade; to meet with the people who could give you their business or could allow you to bid upon that business.

You see, we were under contract with the Government under four master contracts.

The Court: Did you let subcontracts?

A. Yes, we let subcontracts, also.

The Court: Who had charge of that?

A. I let some of the subcontracts and Mr. Sims let the rest of them, and Mr. Barron, of course, our office manager, would let the rest of them.

The Court: Did you have anything to do with the supervision of the work itself or was your work primarily devoted to sales? [31]

A. My work was devoted more to sales and sales management.

The Court: How much of your time did you spend on that?

(Testimony of Marvin Morrow.)

A. Oh, I would say ninety per cent of my time would be spent on that.

The Court: Excuse me for interrupting your examination.

Mr. Miller: Yes, sir.

The Witness (Continuing): —and in negotiation of the job afterwards. You see, I think Mr. Miller mentioned previously that out of all the contracts that we had from the inception of the company to the end——

Mr. Anixter (Interposing): I submit this is not responsive.

The Court: Yes. You go ahead, Mr. Miller.

Mr. Miller: Q: Did your company have occasion to renegotiate contracts for ship repair work?

A., Yes.

Mr. Anixter: Just a moment. I will object to that on the ground that it is incompetent, irrelevant and immaterial, it calls for the opinion and conclusion of the witness, and it is not based on any proper foundation. Renegotiation is something that was demanded by the Government, not by any company, and I think a foundation should be laid to try to determine whether or not the Government is demanding any renegotiation of these contracts.

Mr. Miller: Well, maybe we are using the word "Renegotiation" [32] ill-advisedly, your Honor.

Mr. Miller: Q. In your contracts for ship repair work, were there occasions when there was

(Testimony of Marvin Morrow.)

work done in addition to that set out in the contract?

A. That is what I was about to state, that in probably ninety per cent of the cases that we had the ultimate figure that we received for the contract, that is, the pay we received for the job, the total job was far greater than the original contract set out in the bid.

Q. How would that come about?

A. That would come about by the opening of what they called "Extras" on the job. In other words, extra work found to be necessary to complete that job to its end that it served whoever you were working for.

Q. Would these be found by your company or inspectors of the Governmental agencies or both?

A. It would be found by both of them because, you see, they employed the inspectors on the job and they would order the work done, of course, and we did the work, and we would only be paid for it later after we put in our bill for it.

Q. Now, were there occasions when you had to negotiate, as distinguished from renegotiate, the amount of the bill for the extras?

A. Almost every one.

Q. During the time that your company was in operation, [33] approximately how many ship repair jobs did you do for these Governmental agencies?

A. Well, it was over a hundred, I would say, in my opinion. It is hard for me to calculate that

(Testimony of Marvin Morrow.)

because we did private jobs also on which they was extra work. And some of that was subsidized by the Government, I mean, operating ships under subsidy by the Government.

Q. What percentage of those jobs were subject to negotiation for extras?

Mr. Anixter: I submit that that is incompetent, irrelevant and immaterial, and has nothing to do with this matter. It doesn't involve any of the contracts they are claiming are due. It is just going into a lot of general situations.

Mr. Miller: Your Honor, there is another point involved, too. I am sure the Court is interested in finding out how it came to pass that these men were paid March 8th rather than weekly, and I think we are entitled to bring in evidence to show money accumulated, received in one lump sum at a particular time.

The Court: Well, all right, I will allow the question.

Mr. Miller: Q. What percentage of your jobs were subject to negotiation for the extra work?

Mr. Anixter: Well, I submit that that is——

The Court (Interposing): Well, that's pretty general.

Mr. Miller: All right. [34]

The Court: Can't you get right down to the fact of what the situation was on March 8th?

Mr. Miller: Yes.

Q. I call your attention to the period between January 1st, 1953 and March 8th, 1953. Did you

(Testimony of Marvin Morrow.)

have contracts at that time that were subject to negotiation for additional work?

A. Oh, yes. I believe that some of those are still open.

Q. Now, you paid your men on a weekly basis, is that right?

A. Yes. That's the Union contract.

Q. Did you get paid on your contracts on a weekly basis? A. No, sir.

Q. When did you get paid?

A. We got paid whenever we could finish the settlement of the job with the particular agency, we were working for, or with their negotiators or inspectors. We would have conferences on each particular job at the end of the job.

Q. Each particular job would be handled on its own merits, is that right? A. Oh, yes.

Q. Would it take more than a week after the job was completed?

A. Well, just for instance, we were hired after we left Mechanix, Inc., we were hired by the Board of Trade to assist in the negotiation of contracts still open. We worked for a month or so on that particular work. [35]

Q. Now, during this period from January 1953 to March 8th, 1953 I think you said you had contracts that were open for negotiation?

A. Yes.

Q. As a result of that having contracts open for negotiation was your corporation without sufficient

(Testimony of Marvin Morrow.)

funds, cash, to pay your salary and that of Mr. Sims?

Mr. Anixter: I object to that on the ground that it is incompetent, irrelevant and immaterial, calls for an opinion and conclusion of the witness as to why he was not able to pay it, and whether or not because of so called renegotiation, which is a word that is being idly used here, they could pay or not. I don't see what bearing it has.

Mr. Miller: We will use the word "Negotiation," instead of "Renegotiation," your Honor.

Mr. Anixter: Even then there has been no foundation laid for any negotiation matter. They haven't even established a contract which sets forth how negotiations would be opened or that they have even complied. We understand the contract provides they have to get an authorization in advance for extras, and there is no evidence they even attempted to.

The Court: Well, these matters I take it, were examined into in the bankruptcy proceedings. There must be some reason for the fact that there is only a small amount of money left to pay a large amount of creditors. The testimony [36] shows you paid most of the secured creditors, and there is \$27,000.00 left and there is \$191,000.00 worth of creditors' claims on file. Is that right?

Mr. Anixter: Yes, that is correct.

The Court: Now, where did that money go?

Mr. Anixter: What money?

The Court: Well, these assets. A hundred and

(Testimony of Marvin Morrow.)

fifty five thousand dollars worth of current assets.

Mr. Anixter: Your Honor, we show they are merely claims that were in the minds of these people.

The Court: Well, it shows contracts receivable of \$150,000.00, of which according to the statement here, \$150,000.00 was payable to the bank. I suppose that is what is meant by "Partially pledged."

Mr. Miller: Yes, the bank had a pledge that was a receivable.

The Court: I don't quite understand what we mean by general observations as to the nature of the business. The question is, what was the financial condition at the time, isn't that so?

Mr. Miller: Well, we are trying to put in specific——

The Court: It appears to be useless for me to hear the witness testify as to the general nature of the business unless it appears that there is——

If this offered that there was no showing that there was [37] no bankruptcy at the time? That there was solvency?

Mr. Miller: It has always been our position that it was solvent, your Honor, although we must confess that there has been an adjudication.

The Court: Well, that would have to be proven——

Mr. Miller: Yes.

The Court: ——or the evidence would have to concern itself specifically with the items that were

(Testimony of Marvin Morrow.)

involved, not general statements about it.

Mr. Miller: But we are entitled to show that these men believed the corporation to be solvent at that time.

Mr. Anixter: Oh, your Honor, please, "They have to show"? They have to show that it was solvent.

For example, the mere showing that these people honestly believed that these claims were due from the United States, and even though, as the accountant's testimony shows, it still wouldn't be enough to pay the obligations, that still wouldn't make them solvent because under the Bankruptcy Law the definition of solvency is whether or not the aggregate value of their assets would be sufficient to pay their obligations, and if they merely had claims that were not reducible to cash, even those claims would not make them solvent unless they were outright accounts receivable rather than disputed claims against the Government.

Mr. Miller: It goes a step further, your Honor. Not [38] only must the corporation be insolvent, but the creditor receiving the payment must have knowledge of the insolvency.

Now if these men honestly believed that the corporation was solvent rather than insolvent, then they could not know that the corporation was in fact insolvent, if that be the case, so therefore their belief as to the solvency or insolvency becomes material.

The Court: Well, that would be self-serving,

(Testimony of Marvin Morrow.)

wouldn't it, to say "I thought we were solvent"?

Mr. Miller: Well, that is why I am trying to develop the facts of it, your Honor, rather than just the mere opinion and statement by the defendants that they believed it.

And we must further dispel any inference that the Court may draw from this payment of March 8th, 1953, by showing that the money came in at one time.

The Court: Well, there must be some reason for the filing of this involuntary petition here on the 13th of March.

Mr. Miller: Oh, yes.

The Court: There must have been some impending proceeding, some black cloud on the horizon, at the very time that they paid themselves this money. Although there is always the eternal hope that something is going to work out in these matters. Lawyers are familiar with that.

But we have gotten a little bit far afield from the precise question. If you wish the witness to testify as to [39] his knowledge of the condition of the company on March 8th, 1953, of course you have a perfect right to go into that.

Mr. Miller: I want to do that, your Honor. And I also want to let the Court know on what he bases his statements rather than just a bare statement of his opinion.

The Court: Well, we have gotten away from the question. Suppose you reframe another question.

Mr. Miller: Yes, your Honor.

(Testimony of Marvin Morrow.)

Q. Mr. Morrow, you were familiar generally with the affairs of that corporation and the company during its period of operation, is that right?

A. Yes, sir.

Q. Calling your attention to March 8th, 1953, did you know or believe that this corporation was insolvent and would not be able to pay its debts?

A. No, sir.

Mr. Anixter: Well, that is calling for his opinion and conclusion.

The Court: Well, it's a factual question.

Mr. Miller: Factual question.

The Court: Subject to — entitled to whatever weight the Court can give it.

Mr. Miller: Q. You were familiar generally with the nature of the assets of the corporation, were you not? A. Yes, sir.

Mr. Miller: Mr. Anixter, may I have that schedule? We are going to use Mr. Anixter's office copy of the schedule, your Honor, rather than bring in the whole trial from the Bankruptcy Court.

Mr. Miller: Q. I show to you the schedule of affairs filed by the corporation in the bankruptcy proceedings, and I direct your attention to the assets which are listed in Schedule B -3-A-1, a total of \$203,720.21, and I note that you signed this schedule. A. That is right.

Q. And I ask you to tell us at this time on what you based the statement that the corporation had that asset. A. Yes, sir.

Mr. Anixter: Well, I submit, your Honor, what

(Testimony of Marvin Morrow.)

he bases it on is not relevant or material, but what the books show he got it from.

The Court: Well, I will allow the question. Recovery of preferences, particularly when it involves the payment to the officers of the company as distinguished from creditors, as is the usual case we meet—I will allow it.

The Witness: A. The type of jobs upon which we worked—I will have to go back to the start of the company—grew naturally in size with the progress of the company.

Now, previous to November of 1952 the largest job we handled ran up to something like, let's say, a hundred thousand. [41] Now, with the negotiations of extras on it it might run up to a hundred and fifty thousand. I don't recall the exact figures. It was an aluminum decking job we did for the Navy—incidentally, on which we received an award for doing good work.

Now, in November of 1952 we bid upon and were successful in the bid of a job which ran over three hundred thousand.

Now, the negotiation of the extras on all of our jobs prior to the Union—the Union is the big one I am talking about in November, 1952—required two, three, four months to obtain our money so that we could pay back the bank and so that we could pay back the creditors, and so forth.

Now, we were not allowed to have the time to negotiate out the Union when the petition in bankruptcy was presented. We didn't even have the

(Testimony of Marvin Morrow.)

time to accumulate our data on payroll and accumulated material, to say nothing of present our claim to the Government. We had to estimate it on the basis of what we could see.

It takes hours and hours of time. That is part of my job, part of the office manager's job. It is part of Mr. Sims' job, who is superintendent, to calculate those hours.

We had to estimate a lot of that because, you see, the Union grew from three hundred thousand to, let's say, over five hundred thousand in our opinion. [42]

The Court: Do you say that after the bankruptcy there was still some amount due, according to your contention, from the Government on this contract?

A. Yes, sir.

The Court: After the bankruptcy did you take any part in assisting the trustee or receiver assemble data to present and accomplish the recovery on that claim?

A. Your Honor, I assisted in the recovery of money on an Army transport job and two or three others with the MSTs. I didn't on the Union, because they didn't give us time. We had five or six jobs we still——

The Court (Interposing): You are going too fast for me. You said that on the Union contract there was money that you thought was due your company from the Government on that contract? A. Yes.

(Testimony of Marvin Morrow.)

Q. What did you personally do about that?

A. We didn't personally do anything after the bankruptcy, because they took all of our books. They took everything, lock, stock and barrel.

The Court: Didn't the trustee call upon you to assist in getting up the data?

A. Not on the Union. They didn't call for us to negotiate one single thing on the Union. They called for us to negotiate on the Army transport job, the name of which escapes me, but [43] I could get it from Mr. Sims.

The Court: You did on some of the jobs?

A. Yes, sir.

The Court: And was recovery made by the trustee on those? A. Yes, sir.

The Court: Well, what happened to the Union?

A. Well, the Union is still open. It's still negotiable. That cannot be disputed.

The Court: How much would that amount to?

A. Pardon? Oh, I don't have the breakdown here, but I think the negotiations for the Union, what we have recoverable, is over a hundred thousand. I mean, I don't know exactly, because it has been a long time. It has been three years.

The Court: You say you could have recovered a hundred thousand dollars more from the Government?

A. Yes, sir. Possibly more.

The Court: And none of that has been recovered?

A. No, sir. Those are extras due over and above

(Testimony of Marvin Morrow.)

the contract. Now, we received monies from the Union. But, you see, the Union was a job that I think we originally scheduled to finish in November of 1952, or maybe the early part of December, but we didn't finish until January of 1953, and we didn't have time to negotiate. It's a small company. We do a lot of things like sweeping the floor, things like that. We don't [44] have a lot of help. We don't have a large staff. We have to negotiate our own paper. Between January of 1953——

Mr. Anixter: I submit we are getting very far afield.

The Court: You are telling me the Government really owes you or this company a hundred thousand dollars that hasn't been collected?

A. Yes, sir. In our opinion that's what they owe us. That's based upon the extra work which we did for which we did not receive payment.

The Court: Well, you probably may have some more questions?

Mr. Miller: Yes.

The Court: We will take a brief recess.

(Short recess.)

Mr. Miller: Q. Mr. Morrow, was there a shortage of cash in the company during this period between January, 1953, and March of 1953?

A. I would say a shortage of working capital, yes.

Q. And that was due to the fact that you had jobs that were subject to negotiation, is that correct?

A. Yes, sir.

(Testimony of Marvin Morrow.)

Q. And had you received or had on hand the cash that you claim is represented by the accounts receivable, and which in turn were based upon negotiations which you say you had with the various governmental agencies, you would have had sufficient [45] cash, working capital, to operate it at the time? A. Yes.

Mr. Anixter: I submit that is incompetent, irrelevant and immaterial; calls for the opinion and conclusion, and a self-serving statement. He doesn't ask if there were any monies due on the contract, but he said if he had all the money he claimed was due.

The Court: Well, that is what he said. He said if he had all the money he claimed was due, he would have had sufficient money to operate.

Mr. Anixter: But there is no foundation laid that the money was actually due.

Mr. Miller: Well, that's the question.

The Court: Yes, but that is the extent of his answer.

Mr. Miller: Q. Mr. Morrow, did the corporation received payments during March of 1953 on account of its work, either in progress or work that had been completed? A. Yes, sir.

Q. Did that money that you received furnish you with sufficient capital to allow the corporation to pay you and Mr. Sims the wages that were owing for this period beginning January 4th or 5th through March 8th of 1953? A. Yes.

(Testimony of Marvin Morrow.)

Mr. Anixter: That is incompetent, irrelevant and immaterial. [46]

The Court: Well, obviously the money must have come in.

Q. (By Mr. Miller): The money was there?

A. Yes.

Q. Did the corporation have sufficient cash on hand prior to March 8th, 1953, to enable the corporation to have paid you and Mr. Sims?

A. At what time?

Q. Between January of 1953 and March of 1953, which is the period covered by this payment of \$1500.00.

A. Of course a different amount would have been owed in January than in March, naturally, or in February.

The Court: What was the last time that you and Mr. Sims received any payment for salary or compensation due you prior to March 8th?

A. Well, we received the wage right along we had agreed upon at the beginning, which we had never increased.

The Court: Well, that doesn't answer my question.

The Witness: Each week.

The Court: On March 8th there was \$150.00 paid each of you?

A. Yes.

The Court: Well, it required discussion. Prior to that time when was the last time you received any money for services?

(Testimony of Marvin Morrow.)

A. I think we had been paid each week.

The Court: How much? [47]

A. Our regular salary which was \$150.00 a week.

The Court: What was this 150 for?

A. This represented a raise which we had given ourselves on the first of the year, 1953. Or we had settled upon this in 1952, of course, but set it on the books in 1953.

The Court: Now, at any time since January, since the time you increased your salary, had the amount of that raise been paid to you since you had agreed upon it? A. No, sir.

The Court: This was, then, an accumulation of what you say was a raise that was finally paid to you on March 8th, 1953, is that a correct statement?

A. Yes, I would say so.

Q. (By Mr. Miller): And when had that raise been decided upon, Mr. Morrow?

A. Well, we had actually decided upon it in 1952, but we hadn't put it on the books until 1953. I would say perhaps the middle of 1952. I don't know the exact date. It was a verbal thing. We had worked for the same wages since the inception of the company.

The Court: But that doesn't answer the question. I just asked you when it was.

A. Some time, I would say, in 1952. Maybe the summer of 1952. [48]

Q. (By Mr. Miller): You say "we." Who do you mean?

A. Mr. Sims and myself.

(Testimony of Marvin Morrow.)

Q. And what consideration led you to vote yourself the raise?

Mr. Anixter: That is incompetent, irrelevant and immaterial, has nothing to do with the issues of this case.

The Court: Well, no, I don't suppose so.

Mr. Miller: All right.

The Court: Except insofar as—is there anything of record as to that in the corporation books?

A. Yes, I think so.

The Court: Except that it might enter into the—it might be a factor that would go to the validity of the opinion. I mean, I don't know why you would particularly object to that.

Mr. Miller: I realized he hasn't raised the question yet, your Honor, but I thought while I had him on the stand I would ask him. If you don't raise the question, I won't go into it.

The Court: Apparently the trustee is relying entirely upon the claim that the payment was voidable as a payment made in contemplation of bankruptcy. He hasn't said that.

Mr. Miller: I will withdraw the question, then.

Q. Mr. Morrow, during this period from the 1st of January, 1953, to March 8-March 13, 1953, did you as the office manager of the company, or did anyone else acting on behalf of the company, make any attempt to raise additional working capital [49] for the company? A. Yes, sir.

Q. Can you tell what efforts were made?

A. Well, I think the only effort that was made,

(Testimony of Marvin Morrow.)

of course outside of personal inquiries of which I have no record, the only effort that was made was made by a Mr. Al Hood, who of course was employed by Mechanix, Inc. He wasn't an officer.

The Court: Can't you just tell us briefly? What was done?

A. Well, we let Mr. Al Hood, at least Mr. Sims and myself had several conferences with him, and he wanted to become a part owner of Mechanix, Inc. He was going to bring in additional working capital. He knew that if he did——

The Court: Well, did he bring it in?

A. No, he didn't bring it in.

The Court: You made some effort to get additional capital from him, but you were unsuccessful?

A. Well, we went further than that. We had an express agreement with him.

The Court: Irrespective of the nature of it, you made the effort to get additional capital through Mr. Hood, but it was unsuccessful. Is that a fair statement?

A. No, I wouldn't say that. He didn't bring any money up until March, but——

The Court: You didn't get any money from him?

A. No, we didn't, your Honor, but it was still open.

Q. (By Mr. Miller): Mr. Morrow, was it your intention at the time you received this payment on March 8, 1953, to continue in the employ of Mechanix, Inc.?

A. Yes, sir.

(Testimony of Marvin Morrow.)

Mr. Anixter: That is incompetent, irrelevant and immaterial.

A. Yes, sir.

Mr. Miller: I think it is important, your Honor. It could be consideration for the payment as a fact for the Court to consider.

The Court: I would assume that would be the case. Ask another question.

The Witness: I didn't finish my answer.

The Court: Well, I think we have heard enough. I will take it for granted that, whether it is material or not, you were going to continue on in business if you could.

Mr. Miller: Did you want to ask a question, or did you tell me to?

The Court: I will answer it for him.

The Witness: I want to go a little further.

The Court: Well, you weren't going to leave the business, were you?

A. Yes, I was going to leave the company.

The Court: You were?

A. Yes, sir. [51]

The Court: Then I was wrong.

The Witness: I wanted to explain to the Court why.

The Court: Well, what is the materiality of that? Why did you want to bring that out?

Mr. Miller: I think that would be a question of consideration for the payment, your Honor. That's the point I had in mind.

(Testimony of Marvin Morrow.)

The Court: I think there was already perfectly valid consideration for the payment.

Mr. Miller: No, I say as a matter of law, insofar as this proceeding is concerned, a present consideration should take it out of the preference class.

The Court: How could that be when he has already testified it was back payment that was owing from January, \$150.00, as a salary?

Mr. Miller: The point is, he received the payment in order to keep him on the job, which would make it a present consideration.

The Court: I don't think I would go into that. I don't see any merit in that. I don't think a man has to say he is going to stay on the job to get some money that is already owing him.

The Witness: I could explain that.

The Court: You don't need to. I don't think it is necessary. It is only a legal question. If money is owing [52] to you, it is owing to you. A man doesn't have to stand on his head to get something that is already owing him.

Mr. Miller: I have no further questions of this witness.

Cross Examination

Q. (By Mr. Anixter): Mr. Morrow, it is a fact your company closed its books monthly, is it not?

A. Well, we weren't always successful in closing monthly. We tried to.

Q. Mr. Morrow, I will show you a copy of an operating statement of Mechanix, Inc., for Febru-

(Testimony of Marvin Morrow.)

ary, 1953, which was taken from your files, and ask you if you have ever seen that statement.

A. For what period is this?

Q. February, 1953. Operating statement.

A. I mean, is it only for February?

Q. Well, it is your record, operating statement for February.

A. I have seen the statement before.

Q. And this statement shows that the net profit before taxes in February, 1953, was minus \$9,663.12, is that correct?

A. It is perfectly possible in that month, yes.

Mr. Anixter: I will ask that this be introduced as Trustee's Exhibit.

Mr. Miller: We object on the ground it is incompetent, irrelevant and immaterial.

The Court: He has only offered it to show it was an [53] operating statement for that month. I don't know precisely what the materiality is. Well, I will admit it.

(Operating statement referred to admitted into evidence as Plaintiff's Exhibit 2.)

MECHANIE, INC.
OPERATING STATEMENT
February 1953

64

Revenues from Contracts

\$ 33,962.32

Less direct costs:

Materials for repairs	\$ 8,481.51
Sub-Contracting	2,409.40
Direct Labor	9,284.97
Other direct costs	<u>861.75</u>
Total direct costs	

21,037.63

Gross Profit

\$ 12,924.69

Less Operating Expenses:

Salaries-Admin., Superv., & Clerical	\$ 9,247.08
Rental of Equipment	2,217.00
Maintenance or Replacement of Rental Equipt.	2,250.00
Rental of Pier	1,676.94
Accounting	164.00
Amortisation of Leasehold improvements	154.58
Auto and Travel	13.00
Bridge Tolls	136.75
Depreciation Expense	922.73
Advertising	8.84
Entertainment & Business promotion	673.18
Gasoline, Oil & Fuel	404.85
Insurance	1,148.73
Interest	360.00
Legal	1,225.00
Maintenance & Repairs	573.55
Office Expense	599.12
Telephone & Telegraph	174.62
Utilities	242.04
Losses from theft	375.00
Miscellaneous	20.80
Total Operating Expenses	

22,587.81

Net Profit before taxes

\$ -9663.12

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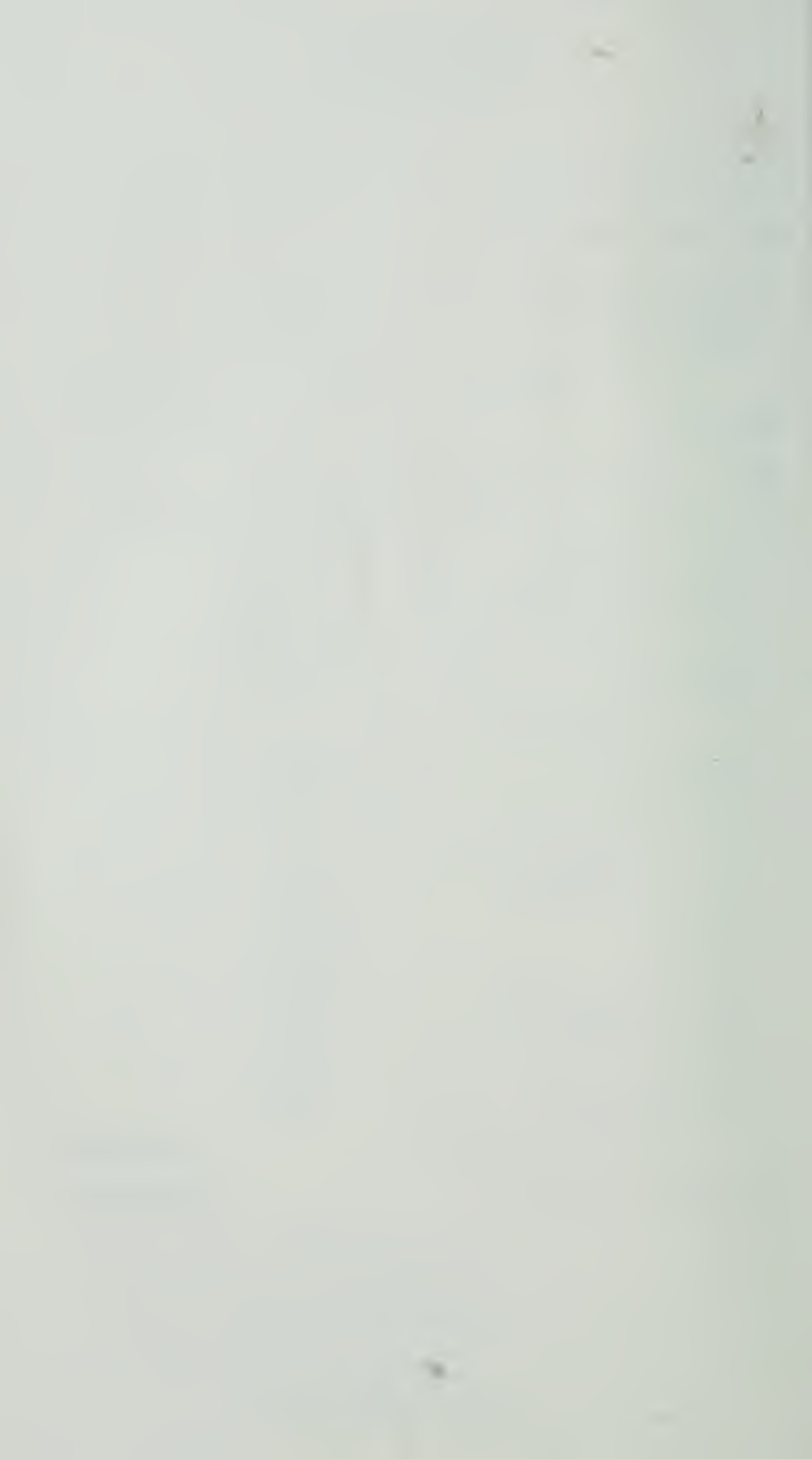
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(Testimony of Marvin Morrow.)

Q. (By Mr. Anixter): Now, Mr. Morrow, on January 20th, 1953, you wrote a letter to the Assistant Industrial Manager of the United States Navy regarding the Union, did you not? A. Yes, sir.

Q. Before showing you the letter, I will show you a notation attached to the letter, purporting to be in your handwriting:

“Dear Mr. Hunt: Here is a copy I made of our Union claim. Have you filed one for this job? M. D. Morrow.”

Is that in your handwriting? A. Yes, sir.

Q. And you sent a copy of this letter to Mr. Hunt? A. Yes, sir.

The Court: Who is Mr. Hunt?

Mr. Anixter: He is one of the attorneys in our office.

The Court: This is after the bankruptcy?

Q. (By Mr. Anixter): And this is a copy of the actual letter sent by you?

A. Yes. January, 1953.

Q. Now, it is a fact, Mr. Morrow, that in this letter you claim there was \$70,000.00 due to you?

A. Yes, sir, and that is January, 1953. As I explained before, we were not through with the—

Mr. Anixter (Interposing): Now at this time I would like to offer in evidence a letter dated January 20th, 1953, to the Assistant Industrial Manager, U. S. Navy, Building 11, Yerba Buena Island, U. S. Naval Station Treasure Island, San Francisco, California. Attention Captain E. T. Aldridge, Assistant Industrial Manager:

(Testimony of Marvin Morrow.)

“Dear Sir:

“Confirming my verbal statements to you in December, 1952, regarding the contract that we completed November 20, 1952, on the USS ‘Union’ (AKA-106) it has been confirmed on the basis of our final figures that we suffered a severe loss in the amount of \$70,000.00. We have analyzed the entire contract and figures in relation to the conditions under which the work was performed and therefore seek reimbursement for our loss by reason of acts of the Government or causes beyond the control and without the fault or negligence of the contractor.

“It has long been the stated public policy of the U. S. Navy that the Navy did not want the contractor to ‘go broke’ by reason of conditions imposed by acts of the Government. In our case under the USS ‘Union’ [55] (AKA-106) contract we acted in good faith. It has been reported we accomplished a workmanlike job and furthermore completed the contract on time and without penalty. Since this was our first contract of any consequence with the U. S. Navy, we sincerely endeavored to make every effort towards a satisfactory performance. As a result of trying to completely please the requirements, orders, and desires of the U. S. Navy ship’s force, inspectors, planners and estimators, contract negotiators, progress men, the Assistant Industrial Manager’s personal staff, electronics assistants, designers and others, we were unable to proceed in the execution of contract in

(Testimony of Marvin Morrow.)

the manner and schedule which we had planned. The net result of the confusing Government interference was our financial loss and we respectively request the submission of our claim with the proper authorities immediately for prompt attention.

"Your cooperation is appreciated.

"Very truly yours,

"M. D. Morrow, President."

Mr. Anixter: I will ask that this be introduced.

Mr. Miller: No objection.

(Letter referred to above admitted into evidence as Plaintiff's Exhibit 3.) [56]

Q. (By Mr. Anixter): Mr. Morrow, the Navy did not agree to pay you that, did they?

A. They never do.

Q. And consequently this not an item that was due you under your contract?

A. Well, that is the type of contract we worked from from the start. All of our jobs went the same way.

Q. Those items were not stated in your contract?

A. No, sir, this is work over and above the contract.

Q. And this is a claim you are making over and above the contract? A. Yes.

Q. And it is not something that was agreed to?

A. That is right.

Q. Now, in all your other contracts you are talking about the situation is the same, is it not?

(Testimony of Marvin Morrow.)

A. Yes.

Q. The United States did not agree to pay you these amounts?

A. That is right. We had to negotiate the extras after the job.

Q. Well, it is something that you wished to negotiate, isn't that right?

A. It is a matter of form. We did it.

Q. You did it, but you wished the Government to pay you that? They did not agree to pay you that? [57]

A. No, sir, I will not say "Yes" to that. We successfully negotiated 80 per cent of our contracts that we worked on, maybe 90 per cent, during the time that we were in business.

Q. For the full amount that you asked for?

A. Over and above the amount of the contract price. If the bid was priced at \$5,000.00, it wasn't unusual for the contract to turn out 15,000, maybe 20,000.

Q. Now, there is a provision in these contracts, is there not, requiring you to get an authorization from the inspector before doing anything extra?

A. No, sir.

Q. In none of your contracts?

A. No, sir. I will answer it this way——

Q. (Interposing) You have already answered. Do you wish to change your answer?

A. Well, I will condition it. Written or verbal contracts?

Q. I am talking about your written contracts.

(Testimony of Marvin Morrow.)

A. On the written contracts, you do not have permission to proceed with anything without authority, but if they give you verbal permission, you proceed.

Q. In other words, you are required to get permission? A. Verbal permission.

Q. Isn't it a fact that the contract requires it to be in writing? A. No, sir. [58]

Q. It is your statement they do not?

A. Well, the contracts do, yes, sir.

Q. Oh, the contracts do provide that you get authorization in writing? You are changing your answer again?

A. It is impossible, sir. At midnight you couldn't get permission.

Q. I am not asking you to argue with me. I am merely asking you what the contract says.

A. Yes, the contract says you must obtain written permission.

Q. That is all I have asked you.

A. Yes, sir.

Q. Now, Mr. Morrow, I will show you the bank statement of Mechanix, Inc., for the month of March, 1953, and if you will look at that——

Mr. Anixter: Pardon me, do you wish to see these?

Mr. Miller: Yes.

Q. (By Mr. Anixter): I will ask you to look at these bank statements, Mr. Morrow, and ask you whether or not it is not a fact that from the 3rd day of March, 1953, onward, there were overdrafts.

(Testimony of Marvin Morrow.)

A. This is March, 1953?

Q. Yes. A. Yes, sir.

Q. And for the entire month, and up until March 11, 1953, there was an overdraft of \$8,864.25, is that correct? [59]

A. That is very possible.

Mr. Anixter: That is all, Mr. Morrow.

Redirect Examination

Q. (By Mr. Miller): Did you have certain contracts pledged to the bank at that time?

A. Oh, yes. All of ours were pledged to the bank and assigned. I guess you would say it was pledged. They were assigned to the bank.

Q. Were those overdrafts had with previous arrangement with the bank?

A. Oh, yes. All our contracts from the United States Government were assigned outright to the bank. They received the money first.

Q. On March 18, 1953, what was the status of the account?

A. 9,000 in the black—\$9,412.00.

Q. On the credit side? A. Yes, sir.

Q. Was it the custom—withdraw that.

Have you been in this business for several years, Mr. Morrow? A. Yes.

Q. And you worked with the inspectors?

A. Yes.

Q. Various branches of the Government?

A. Yes, sir. [60]

Q. Was it the custom of the inspectors to give

(Testimony of Marvin Morrow.)

you oral permission to do work over and above that set forth in the contract? A. Yes.

Mr. Anixter: I will object to that on the ground no proper foundation has been laid. This man was only in business for a year before that time and isn't qualified to know the custom of Government inspectors.

The Court: Well, of course it calls for his opinion and conclusion.

Mr. Miller: Well, it is a matter of business custom.

The Witness: I think the men on the job——

The Court: Well, I will sustain the objection.

Q. (Mr. Miller): Had there been occasions prior to the Union job when your company had done work on oral permission and had been paid by the Governmental agency for that work?

A. Yes.

Mr. Anixter: I submit that is incompetent, irrelevant and immaterial.

The Court: I don't see the competency of that.

Mr. Miller: Well, it is a question of validity.

The Court: Well, he made some other contracts at different times that had a different result. What difference does it make?

Mr. Miller: Well, he had every reason to believe this one [61] would turn out all right.

The Court: It is like saying I made a profit when I sold my 1953 automobile, and my 1952 and my 1951, but ran into some trouble with my 1954. I don't think that that has any materiality.

(Testimony of Marvin Morrow.)

Mr. Miller: I have no further questions of this witness.

Recross Examination

Q. (By Mr. Anixter): Mr. Morrow, at the time you and Mr. Sims took these checks you owed other labor claims, did you not? A. Pardon me?

Q. At the time you drew these checks to Mr. Sims and yourself, there were other wage claimants whose wages had not been paid, were there not?

A. Such as what? I don't know. No, I know of no other claims that were not paid.

Q. There were other creditors' claims, however, that were not paid? A. Yes, creditors.

Q. But is it your contention that the other wage claims were all paid? A. Yes, sir.

Q. As a matter of fact, didn't the Labor Commission come after you for the payment of these?

A. For ours or for whose?

Q. For the others, not for yours. [62]

A. No, sir. The Labor Commissioner came to look into some overtime claims, that is all. Which we disputed, of course. We said it wasn't owed.

Mr. Anixter: That is all.

Redirect Examination

Q. (By Mr. Miller): Your company was current in the payment of wages? A. Yes.

Q. The claims that were filed by the Labor Commissioner in the bankruptcy proceedings were based upon the fact that the bank would not honor the checks after the petition, the involuntary peti-

(Testimony of Marvin Morrow.)

tion in bankruptcy was filed on March 13th, 1953, isn't that right? A. Yes.

Q. And the money then due to the wage earners was simply for that short time period? A. Yes.

The Court: You mean the bank took whatever money you had under your assignment?

Mr. Miller: Yes.

The Court: There was no money in the account to pay the wage claims?

Mr. Miller: Well, I don't know.

The Court: At any rate, there wasn't any money to pay them? [63]

Mr. Miller: They would not honor the checks because of the bankruptcy proceedings. There had been a receiver appointed. The checks were tendered after the appointment of the receiver. Actually, it shows a credit balance in the bank account and there were sufficient funds to pay the checks.

The Court: Anything else of the witness?

Mr. Miller: I have nothing further.

The Court: All right. Witness excused.

DANIEL BARAN

called as a witness on behalf of the Defendants,
sworn:

The Clerk: Please state your name for the Court.

A. Daniel Baran—B-a-r-a-n.

Direct Examination

Q. (By Mr. Miller): Mr. Baran, by whom are you employed at the present time?

(Testimony of Daniel Baran.)

A. C. W. Mardell.

Q. During the year 1953 were you employed by Mechanix, Inc., a corporation? A. I was.

Q. In what capacity?

A. Well, I was the general administrative assistant and helped in all capacities.

Q. When did you enter into the employment of Mechanix, Inc.? A. I beg your pardon?

Q. When did you first start to work for Mechanix? [64] A. In September, 1951.

Q. And you were familiar generally with the kind of work it did?

A. Generally, yes.

Q. What work would that be?

A. With the ship repair work, we worked on the specific repairs of ships, and at the time I went there, they were engaged in a so-called aluminum job for the United States Navy.

Q. During the time that you were there, did you have occasion to work on negotiation of charges for extras on any of the jobs?

A. In some small capacities, yes, sir.

Q. What capacities?

A. Well, in certain instances it might be an accounting for certain installations involved and doing of extras.

Q. Now, you were not an officer of the corporation, were you? A. No, sir.

Q. Nor were you a director?

A. No, sir, I was just an employee.

Q. And now, you were familiar with the job per-

(Testimony of Daniel Baran.)

formed by Mr. Morrow? A. Yes, sir.

Q. Was that as sales manager? A. Yes, sir.

Q. Did you observe whether or not he worked on negotiations of extras? A. Yes, sir.

Q. Were you familiar with this job on the Union? A. Fairly familiar, sir.

Q. Do you know when that job was completed?

A. I don't know exactly. I mean, I can't answer the month. Strange as it may seem, it is a little vague. It was at the end of 1952 or beginning of 1953.

Q. Did you do any work at all in connection with the negotiation of charges for extras on the Union job? A. No, sir.

Q. Would that normally be part of your duties?

A. It would eventually be so far as certain negotiable points that might pertain to my work, it would have eventually come into certain work that I did.

Q. Were you in charge of accounts payable for the company? A. Not directly.

Q. Well, was it one of your responsibilities to arrange for payment of the accounts owed by the company?

A. May I answer the question this way, that I was an administrative assistant. In most cases Mr. Morrow would be called or Mr. Sims, or if necessary, I would answer the questions. Our books were taken care of by someone else. If it was a question of expediting or explaining to a customer why a payment hadn't been made, if the creditor had some

(Testimony of Daniel Baran.)

specific terms, I might or Mr. Morrow or Mr. Sims might talk with the creditor.

Q. What was your salary there?

Mr. Anixter: Incompetent, irrelevant and immaterial. A. \$200.00 a month.

Mr. Anixter: He has no claim.

The Court: Well, let it stand. Go ahead.

The Witness: Shall I answer the question?

The Court: He said \$200.00 a month.

Q. (By Mr. Miller): \$200.00 a month?

A. \$200.00 a week, I beg your pardon.

Q. Had you made any of the arrangements with the bank for banking by the company or loans by the bank to the company? A. No, sir.

Mr. Miller: I have no further questions at this time.

Mr. Anixter: I have none.

The Court: That is all. Witness excused.

Mr. Miller: Call Mr. Sims.

HOWARD SIMS

a defendant herein, called as a witness in his own behalf, sworn:

The Clerk: Please state your name to the Court.

A. Howard Sims.

Mr. Miller: Your Honor, in the interests of time, Mr. [67] Anixter and I can stipulate that Mr. Sims was an officer of the corporation, was the plant superintendent, and was a shareholder; and that his testimony would be substantially that as the testimony of Mr. Morrow with regard to the jobs

(Testimony of Howard Sims.)

and the amounts owing, and so forth.

I don't know, we have the man here if the Court has any questions.

The Court: It is agreeable to me. Is it agreeable to you to stipulate——

Mr. Anixter: Yes.

The Court: ——that the witness would testify substantially as Mr. Morrow in regard to the things he testified to? Is that agreeable to you?

Mr. Miller: Yes.

Mr. Anixter: Yes.

The Court: All right, that is all then. Witness excused.

Mr. Miller: Your Honor, Mr. Anixter and I can stipulate that Mr. Sims and Mr. Morrow drew \$300.00 a week for some period prior to January, 1953. We haven't been all the way back through the record, but we know that between November 30, 1952, and December 7, 1953, both parties drew the full \$300.00 a week.

I realize that this is a correction of the testimony offered by Mr. Morrow, but he just told me he thought he was mistaken and asked me to check the records, which we did. We [68] find that they did in fact receive the full amount of \$300.00 a week.

The Court: This \$150.00 was from January——

Mr. Miller: No, the \$150.00 was to make up the \$300.00. In other words, they had not——

The Court: Oh, they had actually drawn for some period in 1952 \$300.00 a week apiece. From

January on they had only drawn \$150.00 a week?

Mr. Miller: That is correct, your Honor. That is what the record shows.

The Court: Is that according to the record?

Mr. Anixter: Then do I understand, Mr. Miller, that for this entire period between January and March they did draw the \$150.00, and that this check represented the balance that was due on salary?

Mr. Miller: That is my understanding, your Honor.

Mr. Anixter: Then in that case they already got part of the so-called priority wage that they would be entitled to, your Honor.

Mr. Miller: Well, that is another question of law, whether the priority would apply to wages owing or earned.

The Court: What is the limitation?

Mr. Anixter: \$600.00 if earned within three months immediately preceding the filing of the petition. So they would have each received more than \$300.00—— [69]

The Court: They would have received more than \$600.00 apiece.

Mr. Miller: That's if they had received that much, there is no question, your Honor.

The Court: Then there wouldn't be any priority question.

Mr. Anixter: That is correct.

Mr. Miller: But the question is: Would the priority apply to amounts received or amounts

owing—I should say amounts earned or amounts owing.

Mr. Anixter: They are only entitled to a priority of \$600.00.

The Court: Well, they were claiming at the time of the bankruptcy that they had \$1500.00 due, that the salary was \$1500.00 for the previous two months, and if he received \$750.00 of it, his priority is only to the extent of \$600.00, isn't it?

Mr. Anixter: That is correct.

Mr. Miller: Would he be entitled to receive the \$600.00?

Mr. Anixter: He has already received that \$600.00.

Mr. Miller: Or would it be said that he has already received it? That's the question. Frankly, I haven't checked the cases, your Honor.

The Court: I don't know. The *prior* extend to the amount that is not paid, doesn't it?

Mr. Anixter: Well, the priority is just unpaid wages. [70]

The Court: You wouldn't have the question of priority unless you have unpaid wages. You have to start out with that assumption. As to any amount not paid, there would be a priority of \$600.00, wouldn't there, if it was wages?

Mr. Anixter: If it was wages earned within that time, but apparently he had been paid at least half of the total amount earned within that time.

The Court: That is of the total amount, but doesn't the time—the only time the question of

priority arises is with respect to wages that are unpaid.

Mr. Anixter: That is correct, but they must have been earned within three months prior to the filing of the petition in bankruptcy—

Mr. Miller: These were earned during that period.

Mr. Anixter: —and only half of these would have been earned within that period. The other half would have gone on as a balance due before that time.

Mr. Miller: No, they had been paid the full \$300.00 up to January of 1953.

Mr. Anixter: That is correct.

Mr. Miller: So the full amount was earned during the 90-day period.

Mr. Anixter: Oh, I see what you mean.

The Court: You had \$1200.00 a month, roughly speaking. Let's take two months, \$2400.00 that was due. \$1200.00 of that [71] had been paid. Let's take a two-month period. That \$1200.00 was owing them at the date of bankruptcy.

Mr. Anixter: That is correct.

The Court: Doesn't the priority extend—

Mr. Anixter: It apparently was earned within that time, so if they are entitled to a priority, this wouldn't change anything.

The Court: You couldn't have the question of priority unless you had some unpaid wages, so the only question is whether or not this \$600.00, or the amount due each of them, was in the form of wages

that is subject to application of the priority rule.

Did anybody have any more testimony?

Mr. Miller: No.

Mr. Anixter: I wanted to put some testimony in as to the value of these claims.

The Court: All right.

PETER HUNT

called as a witness on behalf of the plaintiff; sworn:

The Clerk: Please state your name to the Court.

A. Peter Hunt.

Direct Examination

Q. (By Mr. Anixter): Mr. Hunt, you are an attorney? A. Yes.

Q. And you are associated with the firm of Shapro and [72] Rothschild?

A. That is correct.

Q. And prior to your association with the firm of Shapro and Rothschild with whom were you associated?

A. I was associated with the firm of Thelen, Marrin, Johnson and Bridges in San Francisco.

Q. And what type of work were you doing with them?

A. I specialized largely in Government contract law there.

Q. Now, Mr. Hunt, Shapro and Rothschild are the attorneys for the trustee in the matter of Mechanix, Inc., a corporation, in bankruptcy, are they not? A. They are.

(Testimony of Peter Hunt.)

Q. And as a member of that firm you have been working on this case? A. Yes, sir.

Q. What phase of the case have you been working on?

A. I have been working on the phase that relates to the prosecution of the claims or supposed claims against the United States Navy.

Q. You have made a complete investigation of this matter?

A. I have made a study of all the outstanding claims, yes.

Q. And are there any of these claims in which the Government has agreed to make any payments?

A. There is one claim in which the Government has agreed to make a payment. The matter is presently before the United [73] States Department of Labor for the liquidation of the amount to be paid. That liquidation will be between three and five thousand dollars. No more than \$5,000.00 can be paid in that matter.

Q. Now, with the exception of that claim, is there any other claim that the Government has agreed to pay?

A. No, all the others are still in the process of negotiation and are disputed by the Government.

Q. They are all disputed by the Government?

A. They are.

Q. Now, I particularly call your attention to the claim of the Union. That is the largest claim, is it not? A. That is right.

Q. Is that claim disputed by the Government?

(Testimony of Peter Hunt.)

A. That is quite right. That is likewise disputed by the Government.

Q. As a matter of fact, have they denied liability?

A. No, they haven't altogether. On one small aspect of that case, the money amount of which will be in the neighborhood of \$8,000.00——

Q. (Interposing) What was the suit and what was that sum? A. Not in excess of \$8,000.00.

Q. Not in excess of \$8,000.00.

A. They have not denied liability. On the other hand, they have not admitted liability. It is still in the process of [74] negotiation as to that one small matter.

Q. As to that one small matter. With the exception of that one small matter, have you formed any opinion as to the value of that claim?

A. I think when you take into consideration all of the legal factors and the factual factors, the trustee in bankruptcy will realize from the Government fifteen or sixteen thousand dollars on account of the Union.

Q. And that is in addition to this other sum that you have mentioned?

A. That is in addition to this other sum, which will not be in excess of \$5,000.00.

Q. And what, in your opinion, would be the outside entire recovery on the claims being processed?

A. On all the several claims, my opinion on the outside value of all the claims being processed by

(Testimony of Peter Hunt.)

me now against the United States Government is \$23,000.00 to \$23,500.00.

Q. And you have taken whatever proceedings were necessary for the collection of these claims?

A. Yes. I have not sued in the Court of Claims, however, because I have felt that in many matters where liability was denied by the Government, it would be worthless to file an action in the Court of Claims. I have taken all the administrative steps necessary to realize from the Government.

Mr. Anixter: That is all. [75]

Cross Examination

Q. (By Mr. Miller): Mr. Hunt, how long were you with Thelen's office?

A. I was with them approximately two years.

Q. That was after passing the bar?

A. Before and after.

Q. Did you do any ship repair renegotiation of work there? A. No, I didn't.

Q. Actually, this is your first case of ship renegotiation? A. Yes, it is.

Q. You say you have not filed suit in the Court of Claims? A. No.

Q. And you don't expect to?

A. I don't intend to file suit.

Q. Now, you say that they have not denied liability as to the \$8,000 on the Union job, but haven't admitted it. What is the attitude of the Government towards that?

(Testimony of Peter Hunt.)

A. I would say on that particular matter, that their attitude is favorable.

Q. Do you have written consent from any inspectors for any of the extras that were performed on the Union job?

A. I can't find them in the file of Mechanix, Inc.

Q. Do you have or did you have consent for any of the extras that were performed and for which the Government paid as you stated here a moment ago? [76]

A. No. However, that was not a matter which related to extras. That was a matter of a setoff against an admitted Government liability.

Q. Admitted Government liability for what?

A. For amounts due under an Air Force contract.

Q. And what was the setoff?

A. The setoff was the overtime wage payments under the Walt-Seeley (sic) Act, and that setoff is the one which is being presently liquidated before the United States Department of Labor.

Q. You mean the Government had a claim against the corporation and set it off against an Air Force contract? A. Precisely.

Q. And you feel that despite the fact that there are no consents to perform extra work, the Government will accept the liability for at least part of it?

A. I think they will, yes.

Q. Why would the Government not accept responsibility for the rest of it in your opinion?

(Testimony of Peter Hunt.)

A. Because the basis of liability is different in many cases. The acceptance by the Government of liability in one case legally is a matter of accommodation. In my opinion they have no legal obligation to accept it without the written consent, and the Court of Claims has so held in some cases.

However, as a matter of accommodation, where there has [77] been undue hardship, as a matter of administrative determination, they will allow an extra without the written consent.

Q. Has the Court of Claims denied recovery to claimants in all cases where there has not been written consent firsthand?

A. There have been cases where both the Court of Claims and the United States Supreme Court have allowed it.

Q. I assume those were instances where there had been previous payment made where an extra work was performed without written consent and the claimant acted in reliance on that previous payment, is that correct?

A. I don't know about that. Estoppel arose where there was considerable detriment to the contractor, after having been promised by the chief contracting officer of a "to-be" executed written authorization.

Q. Have you determined whether or not such is the case in this instance?

A. Based upon my investigation of the facts, I conclude that the facts here don't fit into that case.

Q. Don't you feel a direction of promissory

(Testimony of Peter Hunt.)

estoppel should apply in a case wherein there had been previous payments under a similar set of circumstances and the work was done in reliance on those previous payments?

A. That is an arguable proposition. The great weight of cases is that, notwithstanding the seriousness of payments, any particular payment has to stand on its own feet and you [78] cannot rely on, in other words, what is more specifically to be termed estoppel in pay.

Q. In any event, it is your opinion this is not one of the cases which should be taken up to the Supreme Court to see whether the principle should apply? A. I don't think so.

Q. Have you done the renegotiating with the Government since you came into this case?

A. Yes, by letter and by telephone.

Q. When did you first come into the matter, Mr. Hunt?

A. Just about a year ago, I would say, April or May, possibly March, 1954.

Q. Had anybody worked on it prior to that time? A. Yes, sir.

Q. Who was that?

A. Another attorney in the office. His name is Daniel Cowans.

Q. Did you have any contact with anyone in the office of Harold Faulkner in connection with this matter? A. I personally have not.

Q. Is there anything in the files to indicate that

(Testimony of Peter Hunt.)

Faulkner's office had handled this matter or had worked on it at all?

A. Not in the files I have here. I have a recollection, however, in a file I did not bring with me, there is reference to Harold Faulkner's office. [79]

Q. You yourself have not contacted Faulkner's office about the matter? A. No.

Mr. Miller: No further questions.

The Court: That is all. Witness excused.

Mr. Anixter: The Trustee will rest.

Mr. Miller: We rest, your Honor.

The Court: That concludes the evidence?

Mr. Miller: Yes, your Honor.

The Court: This case doesn't amount to very much when you eliminate the possible priority claims.

Mr. Anixter: There isn't a great deal involved. As far as that priority point is concerned, there is a great deal of authority on there that an officer and director is not entitled to the priority as a labor claim, notwithstanding the fact that he actually put in his time. He is considered as an executive. As this point was not made by Mr. Miller before this morning, I didn't come prepared.

The Court: Well, let me ask you this question: There is no claim made by the Trustee that there was any unauthorized withdrawals or taking away of assets besides this amount involved in this?

Mr. Anixter: No, we are not making any such claim.

The Court: These fellows got into this business

and they weren't sufficiently financed and it cost a lot more than they [80] anticipated, and they bit off possibly more than they could chew, and they really were not equipped financially to handle contracts of this nature, isn't that right?

Mr. Anixter: Yes. In the Bankruptcy Court we did go into the question of a likelihood of unusually large expenditures for entertainment and liquor, but knowing the nature of the business, we didn't see any point in actually going after that because those things are always so hard to prove.

The Court: Well, there wasn't anything particularly equitable about these men getting compensation for their work, even though the creditors got hurt.

Mr. Anixter: Well, they actually did work; there isn't any question about that.

The Court: I don't think there is too much to this case. I can't arouse myself to any great excitement over it.

I would be inclined to say that probably they lost everything they had and the few dollars concerned so far as services were concerned is not of any great moment to the creditors. Unless there was some overbearing reason for it, I certainly—They are entitled to get some money for their services.

They ran up against a situation you probably are familiar with in the bankruptcy court, and which we see frequently in court, that you have to be specially equipped to handle Government contracts. Unless you have the money and the resources and know how to handle it, the Governmental require-

covery, but with knowledge they were insolvent and with intent to actually prefer themselves.

Mr. Miller: If your Honor can satisfy himself that these men or the corporation would have paid Sims and Morrow to go ahead, regardless of any action that might have been contemplated by the creditors, then the Court can find that there was not intent as preferential payment.

If, on the other hand, the only reason these men paid themselves at this time was because they knew a petition was going to be filed, then I would agree with Mr. Anixter and the Court's conclusion that it was an act of preference and was intended only as a preference.

But it is our position the corporation would have paid this money because it owed the money. It had been authorized previously.

The Court: Well, the case depends upon the inferences. There is no primary evidence.

Mr. Anixter: With one exception, that they ran this company. I don't see how anyone could say they were not chargeable.

The Court: That is the very question you want to have decided. There is no evidence who the stockholders were. [84] Was there anybody else besides these two men?

Mr. Miller: I don't believe so.

Mr. Anixter: Yes, there were other stockholders. I believe the corporation bought back some of the capital stock——

The Court (Interposing): Irrespective of that, were there any substantial stockholders besides

these two men at the time of the bankruptcy?

Mr. Miller: I am sure not. They say no. If this were a voluntary petition drawn the same day or the day after the checks were drawn——

Mr. Anixter: It is very close to it. There was a meeting at the Board of Trade.

Mr. Miller: That is true. These men were not invited to it. There is no question there was money owing. There was a shortage of working capital. That is a far cry from insolvency.

I don't want to labor the point. I think we have both covered the matter.

The Court: Well, I will think it over for a day or two. I don't think too much of the case, Mr. Anixter. Most cases of preference are where a creditor comes in and gets the pay in preference against other creditors.

I don't think there is any legal question involved. It is a pure question of fact. I have made some notes and I would like to think it over. [85]

I will mark it submitted.

(Whereupon these proceedings were adjourned and the matter submitted.) [85A]

[Endorsed]: Filed September 7, 1956.

[Endorsed]: No. 15299. United States Court of Appeals for the Ninth Circuit. Walter J. Hempy, as Trustee of the Estate of Mechanix, Inc., a corporation, bankrupt, Appellant, vs. John Howard Sims and Marvin D. Morrow, Appellees. Transcript

of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed: September 10, 1956.

Docketed: September 26, 1956.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 15299

WALTER J. HEMPY, as Trustee of the Estate
of MECHANIX, INC., a corporation,
Bankrupt, Appellant,
vs.

JOHN HOWARD SIMS and MARVIN D.
MORROW, Appellees.

STATEMENT OF POINTS ON WHICH
APPELLANT RELIES

1. Error of the District Court in making underlined portion of the following Finding of Fact, viz:

“2) That within four months prior to the filing of the petition in bankruptcy against Mechanix, Inc., a corporation, paid to each defendant herein the sum of \$1,500.00 which said payment was compensation to each of the said defendants for labor

and services rendered to the said Mechanix, Inc., and that at the said time the said defendants each promised to continue in the employment of Mechanix, Inc.;"

Instead of the underlined portion above set forth the Finding should have ended without the inclusion of said portion.

2. Error of the District Court in making the following Finding of Fact which the evidence before the Court did not support:

"4) That at the time the said defendants received the said payments the defendants did not know, nor did the said defendants have reasonable cause to believe that the said Mechanix, Inc., was insolvent;"

Instead of such Finding, the District Court should have found that under the evidence defendants had reasonable cause to know that said Mechanix, Inc. was insolvent at the time said payments to them were made.

3. Error of the District Court in making the following conclusion of law which the evidence and facts do not support:

"1) That the payments by Mechanix, Inc., the bankrupt herein, of the sum of \$1,500.00 to each of the said defendants, which said payment was made prior to the filing of the petition of bankruptcy against the said Mechanix, Inc., was not a preferential payment by the said Mechanix, Inc.,

to the said defendants made within four months prior to the filing of bankruptcy and that the said trustee in bankruptcy is not entitled to recover from defendants the sum of \$1,500.00 from each of the said defendants.”

Instead of said conclusion the District Court should have entered its conclusion of law that the plaintiff sustained the burden of proving that defendants had reasonable cause to believe that Mechanix, Inc., was insolvent at the time of making the said payments of \$1,500.00 to each of them, and that said defendants and each of them, are indebted to plaintiff in the sum of \$1,500.00.

4. Error of District Court in entering judgment for defendants. Instead thereof, the District Court should have entered judgment for the plaintiff against each of said defendants in the amount of \$1,500.00, plus legal interest, and for plaintiff's costs and disbursements incurred.

Dated: This 21st day of September, 1956.

SHAPRO & ROTHCHILD and
JAMES M. CONNERS,

/s/ RAYMOND T. ANIXTER,
Attorneys for Appellant.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed September 24, 1956. Paul P. O'Brien, Clerk.